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Published by

CALLAGHAN & COMPANY, Inc.

Established 1864.

401 East Ohio Street

Chicago, Illinois

BALLANTINE

ON

CORPORATIONS

FOUNDED ON
CLARK AND MARSHALL CORPORATIONS

By
HENRY WINTHROP BALLANTINE
PROFESSOR OF LAW, UNIVERSITY OF CALIFORNIA

CHICAGO
CALLAGHAN AND COMPANY
1927

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PREFACE

This book is founded upon Marshall on Private Corporations, originally abridged for student use from the well-known three-volume treatise by Messrs. W. L. Clark and W. L. Marshall. It has been the aim of the present writer thoroughly to revise the text to present in comprehensive, clear and concise form the underlying principles and theory of the law of private corporations. This subject, grown to a vast complexity, presents some of the most vital and intricate problems of the mechanism of modern business. There is no field in which it is more difficult to cut through the undergrowth of trite formulas, metaphors and legal fictions and the mass of details to the fundamental realities and reasons of the law.

The order of treatment has been arranged to correspond with that usually followed in law school courses, and also with a logical unfolding of the subject. Concrete examples and illustrations have been given from leading and important cases. Upon doubtful questions, such as the validity of voting trusts and the remedies available against fraudulent promoters, the conflicting arguments have been discussed and the editor has endeavored to extract what seems the true principle. Much new matter has been added upon the difficult topics of disregarding the corporate entity, corporations by estoppel and the liability of associates in defective incorporations, the liability of promoters in different situations, the theory of ultra vires and the effects of ultra vires transactions, the limits on the criminal responsibility of corporations, the basis of stockholders' liability on watered stock, the reorganization of corporations and other topics, as well as the new topics of non-par stock and Blue Sky laws. Non-par stock is treated functionally in connection with the duty of the stockholder to contribute to the capital of the corporation in the chapter on Stockholders' Liability rather than in the chapter on Capital Stock.

Citations have been given to the most recent cases and frequently to those annotated in the annotated case series exhaustively collect-

ing the authorities. An effort has been made to cite and incorporate the invaluable and scholarly contributions contained in the leading law review articles and notes in legal periodicals which are too often overlooked by practitioners and judges. It is hoped that the practitioner as well as the student may receive help in the solution of practical problems from the critical discussion of theory and principle and from the sources of further discussion which are here made more easily accessible. In the appendix will be found a form of certificate of incorporation showing modern methods of control and finance, and also instructive extracts from the new Ohio General Corporation Act.

HENRY WINTHROP BALLANTINE.

Berkeley, California, 1927.

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LAW OF CORPORATIONS

CHAPTER I.

HISTORY, CHARACTERISTICS AND SEPARATE ENTITY; CITIZENSHIP; CLASSIFICATION.

§ 1. Importance and history.—Business corporations have made possible the development of modern industry and commerce. The earliest corporations were ecclesiastical, municipal, educational or quasi-public trading organizations. Private business corporations should be free from restrictions derived from the early idea that to all corporations are delegated public duties and franchises.

Importance of corporate mechanism.—Much of the industrial and commercial progress of the 19th and 20th centuries has been made possible by the corporate mechanism. It has been compared in its importance to the discovery of steam or electricity as motive power, since it has enabled men to utilize energy on a large scale. By its use men may combine their capital and participate in vast business enterprises with a risk limited to the capital contributed and without peril to their other resources and business. The amount of capital needed for modern business could probably be assembled and combined in no other way.

As Mr. Justice Field once said:¹ "And, as a matter of fact, nearly all enterprises in this state, requiring for their execution

¹San Mateo County v. Southern Pac. R. Co. (Railroad Tax Cases), 13 Fed. 722, 743.

Grosscup, J., in National Tel. News Co. v. Western Union Tel. Co., 119 Fed. 294, 60 L. R. A. 805, gives the following eloquent description of the achievements of modern news enterprise, which, "combining the genius

and the accumulations of men, with the forces of electricity, combs the earth's surface each day, for what the day has brought forth, that whatever befalls the sons of men shall come, almost instantaneously, into the consciousness of mankind. Thus, a gun thunders in a harbor on the other side of the earth; be-

an expenditure of large capital, are undertaken by corporations. They engage in commerce; they build and sail ships; they cover our navigable streams with steamers; they construct houses; they bring the products of earth and sea to market; they light our streets and buildings; they open and work mines; they carry water into our cities; they build railroads, and cross mountains and deserts with them; they erect churches, colleges, lyceums, and theaters; they set up manufactories and keep the spindle and shuttle in motion; they establish banks for savings; they insure against accidents on land and sea; they give policies on life; they make money exchanges with all parts of the world; they publish newspapers and books, and send news by lightning across the continent and under the ocean."

History of corporate organization.—The modern business corporation is differently regarded than the corporation prior to the 19th century. The earlier corporations were largely municipal, charitable and ecclesiastical. There were also craft guilds which regulated persons carrying on particular trades. During the 16th century great foreign trading companies were established. These were given a monopoly of trade and often acquired governmental powers in the territories in which they were chartered to operate.²

fore its reverberations have ceased, the moral sequence of the event has taken root in every civilized quarter of the earth. . . .

"Famine arises in India to begin its grim march; it has gotten but little under way until a counter army—the unfailing benevolence of human kind—has been mustered from America to Russia. On an isolated island, and without premonition, a mountain claps its black hands upon the population of a city; almost before a ship in the harbor, with tidings of the catastrophe, could have set sail, relief ships from the harbors of Christendom are under way." Such agencies of service as these are made possible by corporate enterprise.

In *Paul v. Virginia*, 8 Wall (U. S.) 168, 181, 19 L. Ed. 357, Field J. says, "at the present day corporations are multiplied to an almost indefinite extent. There is scarcely a business pursued requiring the expenditure of a large capital or the union of large

numbers, that is not carried on by corporations. It is not too much to say that the wealth and business of the country are to a great extent controlled by them."

² W. S. Holdsworth, in an article on English Corporation law in the 16th and 17th Centuries—31 Yale Law Jour. 382, states of this period: "The largest part of the law still centered round the boroughs and various ecclesiastical corporations sole or aggregate. But hospitals and colleges had begun to increase; and, at the end of this period, commercial corporations were assuming a position of great importance." See also Holdsworth's History of English Law, 3rd Edition, volume 3, pp. 469-482. The English East India Company was organized in 1600. The colony of Massachusetts was founded by a chartered company incorporated in 1629. See 3 Enc. Laws of England, pp. 239, 243, Companies, Chartered. 8 Holds-

Roman ideas of corporations do not seem to have directly influenced the development of English Law.

Business organizations, using the Roman *societas* as their legal frame-work, spread in the commercial communities of Italy and Germany during the Middle Ages. In the later law of Continental Europe, corporation and partnership were both called *societas*, (*Gesellschaft*, *societe*, *sociedad*, *societa*) and the corporation was distinguished from the partnership by the adjective "anonymous," indicating the fact that the liability of the associates was limited to their contribution and that the personality of the organization was different from that of its members.^{2a}

To form such "anonymous associations" generally necessitated the obtaining of a state license. During the nineteenth century, such licenses have been generally abrogated in Europe or reduced to the mere formality of registering the fact of association which involves publicity of the purpose and capital involved.

In a valuable article, *The History of the Law of Business Corporations before 1800*, Professor Williston points out the early attitude toward corporations as having public functions delegated to them by the state.

"The idea that the object of a business corporation is the public one of managing and ordering the trade in which it is engaged, as well as the private one of profits to its members, may also be noticed in the charters granted to new corporations. . . . At the end of the 17th century the advantages of corporate enterprises seem to have been realized, and acts of Parliament, authorizing the king to grant charters to various business associations were more frequent."³

Ecclesiastical corporations, municipalities, guilds, educational and eleemosynary corporations, regulated companies, joint stock

worth, *History English Law*, p. 200, Application of the corporate idea to commercial societies, commercial advantages.

^{2a}The statement as to corporations in *Roman and Civil Law* is contributed by Professor Max Radin.

See Radin, *Roman Law*, Chap. 12.

For the carrying on of business a type of association was long known in Roman law called *societas*—ordinarily translated as "part-

nership," and like our partnership except that it did not have the characteristics of unlimited liability and almost unlimited agency in respect to third persons.

There was a tradition at Rome that craft guilds in the strict sense—fullers, tanners and the like—had been established by the legendary king, Numa, as early as 700 B. C. The only historical value of the tradition is that it points to the great age of such guilds in Rome.

³Samuel Williston, *History of Law of Business Corporations*,

companies, colonial companies, all these were at first dealt with as subject to the same legal limitations. This historical confusion of different types of corporate organization exercising different functions has had some unfortunate results in unreasonable restrictions in the law as applied to modern business corporations. It has been pointed out that "The common law as developed with reference to corporations organized for religious or governmental purposes was applied to others organized for business purposes. . . . Towns, churches, banks, manufacturing and trading companies were lumped as corporations. . . . Gradually after 1800 general statutes were passed which applied only to specified groups of corporations."⁴

As Henderson says, "To the early American colonist, the term corporation connoted a great privileged trading company; the foreign corporation par excellence of the 16th and 17th centuries. These huge corporate aggregations, controlling foreign trade, exploring unknown lands, governing dependencies, dickering with foreign princes, raising armies and levying war, were the principal objects of the 'dollar diplomacy' of those days."⁵

The foremost object of incorporation was to gain special privileges not enjoyed by other citizens. . . . "The identification of incorporation with the grant of special and exclusive privileges or monopolies, and the fear that the corporation would infringe on the 'natural rights' of citizens was the chief source of the early opposition to corporations."⁶

The ordinary business corporation, however, is not organized for the purpose of performing any public function and the state has no particular interest in its powers or their exercise. It is only those who invest their money in them as stockholders or bondholders or deal with them as creditors, who have a substantial interest in keeping them within the limits of their corporate purposes or in their existence or dissolution. Certain rules as to corporations had their origin at a time when corporations

² Harv. Law Rev. 105, 111, 113; 3 Select Essays Anglo Am. Law 234.

⁴ Davis, Essays in Earlier History American Corporations, p. 4.

⁵ Henderson, Foreign Corporations p. 10. See J. P. Davis, Corporations, Vol. 2, chaps 3-5; Jos. S. Davis, Earlier Hist. Am. Corporations, p. 41; 3 Enc. Laws of England, Com-

panies, Chartered, pp. 239, 254. The East India Company, The Levant Company, The Royal African Company, The Hudson's Bay Company, The South Sea Company were companies chartered by the Crown for the encouragement of foreign trade.

⁶ Henderson, The Position of Foreign Corporations in American Constitutional Law, p. 19.

were created by special charters, the grants of which conferred valuable and exclusive franchises upon the grantees which were of public concern. The reason for some of these rules has entirely ceased in respect to ordinary business corporations formed under general laws, the privileges of which are open to all who comply with statutory conditions, simple and formal in character, and associate themselves for the prosecution of private business.⁷

The modern law of corporations has grown up largely through the decisions and the legislation of the nineteenth century. The first English textbook, Kyd on Corporations, published in 1793, dealt mostly with municipal corporations. As Justice Miller of the U. S. Supreme Court has said, "The law of corporations has been so modified, liberalized and enlarged, as to constitute a branch of jurisprudence, with a code of its own, due mainly to very recent times. To attempt therefore to define a corporation or limit its powers by the rules which prevailed when they were rarely created for any other than municipal purposes, and generally by royal charter, is impossible in this country and at this time."⁹

Advantages of corporation over partnership.—There are some serious dangers and inconveniences which are incident to association in a partnership. First and foremost, each partner is personally liable on all the contracts and indebtedness of the firm, and so may lose much more than the capital invested in the business. Second, each partner is bound by the acts of every other member of the firm within the scope of the firm business. Third, death, bankruptcy or the sale of one partner's interest in the firm will dissolve the firm. These and other disadvantages lead business men to organize most businesses of any considerable size in the corporate form.

The advantages which exist in conducting business in corporate form and which are not enjoyed by partnerships are principally the continuity of the business, without interruption by death or accidental dissolution, the distinct corporate entity or capacity, the exemption from individual liability, the facility of the transfer of one's interest by disposition of shares of stock,

⁷ Goodwin v. Von Cotzhausen, 171 Wis. 351, 177 N. W. 618.

⁹ Miller J. in Liverpool & London

Life & Fire Ins. Co. v. Massachusetts, 10 Wall. (U. S.) 566, 19 L. Ed. 1029.

the ease of attracting investors and assembling capital, the methods of administration of the business by a board of directors acting through officers and agents, and the stability and permanence of the organization.¹⁰

The limitation of liability has been the chief factor in facilitating large scale operations, as every enterprise involves risk, and if large the risk is the greater.¹¹ The ease of transfer of corporate shares also attracts investment buying as well as speculation. The concentrated management and control of the corporate form promote efficiency, but also create the possibility of abuse of power.

§ 2. Definition.—A corporation is an association of individuals, or sometimes of individuals and other corporations for some joint enterprise, invested by the law with capacity to sue and be sued, to make contracts, to take, hold, and convey property, and to do other acts like a single individual.

A corporation may be regarded as a person or legal entity with rights and duties distinct from those of its members; and as such it has

- (a) The capacity of succession, which is the capacity continuously to exist as the same organization, notwithstanding the death, withdrawal, or change of its members.
- (b) The capacity to enter into contracts in its corporate name like an individual.
- (c) The capacity to take, hold, and convey property in its corporate name like an individual.
- (d) The capacity to sue and be sued in its corporate name like an individual.

A corporation may be defined as an association of persons for some joint enterprise invested by law with capacity to act as an entity or person. The idea of separate personality is a method

¹⁰ *Flint v. Stone Tracy Co.*, 220 U. S. 107, 162, 55 L. Ed. 389, 31 Sup. Ct. 342, Ann. Cas. 1912 B 1312.

¹¹ As Ex-President Eliot of Harvard has pointed out, the corporation is the great factor in modern business. "The principle of limited liability is by far the most effective legal invention for business purposes made in the nineteenth century—not that corporations have not other advantages over partnerships, such as the advantageous holding of real estate, the easy transference of the stockholders'

interest and convenience in suing and being sued; but the fundamental advantage of a corporation, the advantage which enables it to mass and direct capital, is the privilege of limited liability." Quoted by W. W. Cook, 19 Mich. Law Rev. 583.

The disadvantages of incorporation are the tax burdens laid on corporations, such as organization fees, franchise taxes, foreign state taxes, the special regulations imposed on corporations, the prejudice against corporations in litigation;

of separation of the rights and liabilities arising out of the enterprise from the other affairs of the members. It has various consequences, such as the continuity of the corporate enterprise, although the members of the association may frequently change. Contracts are made and property is held and litigation is carried on in the corporate capacity, and the group is enabled to act as a continuing unit.

Kyd said, in his early treatise on Corporations, that "a corporation . . . is a collection of many individuals, united into one body, under a special denomination, having perpetual succession under an artificial form, and vested, by the policy of the law, with the capacity of acting, in several respects, as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued, of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive, according to the design of its institution, or the powers conferred upon it, either at the time of its creation, or at any subsequent period of its existence."¹²

Chief Justice Marshall's description lays more stress on the existence of the legal entity. "A corporation," he said, "is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. Among the most important are immortality, and, if the expression may be allowed, individuality; properties, by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand.

the variety and confusion of legislative enactments, and the expensive formalities often required in such matters as the increase of stock or amendment of the articles, or doing business in other states.

¹²¹ Kyd, Corp. 13; New York Trust Co. v. Edwards, 274 Fed. 952; Cincinnati Volksblatt Co. v. Hoffmeister, 62 Ohio St. 189, 200, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707.

See Hohfeld, 9 Columbia Law Rev. 288, 289; 10 id. 296; Fundamental Legal Conceptions, 194, 198, 201.

"A corporation is after all only an association of individuals under an assumed name and with a distinct legal entity." Brown, J., in Hale v. Henkel, 201 U. S. 43, 71, 50 L. Ed. 652, 26 Sup. Ct. 370.

It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities, that corporations were invented, and are in use. By these means, a perpetual succession of individuals are capable of acting for the promotion of the particular object, like one immortal being."¹³

The artificial or fictitious "personality" of the corporation is a way of describing the legal fact that the changing group is treated as a continuing unit which has rights and duties distinct from those of any or all of its members. The enterprise goes on to success or failure as a separate thing. The personality is a figurative and convenient method of describing this separateness. But the privilege is real enough. The figure of speech describes a reality,—a separate capacity, a legal privilege, which the law will not permit the persons enjoying it to misuse. Restrictions on the abuse of the corporate privilege are often referred to as "disregarding the entity."

§ 3. Franchise.—Corporate existence and capacity are derived from positive authorization or grant by governmental authority. Primary and secondary franchises are to be distinguished, the franchise to be as contrasted with the franchise to do.

Creation of corporation.—In England there were a few exceptional cases of ancient bodies corporate at common law existing by prescription or user, viz., universities and boroughs, which obtained recognition before the principle was developed that corporate capacity is a special privilege, or gift of the state. Corporations were created in England either by royal charter or by special Act of Parliament. In England in the year 1844 there was passed the first general incorporation law or companies act under which persons could become incorporated by complying with certain formalities without the necessity of a special Act. It was not until 1855 that the first general limited liability act was passed in England. By the middle of the 19th century, general enabling acts, under which manufacturing and mining companies could be organized had become common in the United States. Now corporations may be organized under general laws for the conduct of almost any line of business by simple formal-

¹³ Trustees of Dartmouth College v. Woodward, 4 Wheat. (U. S.) 518, 636, 17 L. Ed. 629.

"Invisible and intangible" the corporate person is said to be, yet

it has been remarked that it is readily seen and touched by those who gather in the taxes for the government.

ities of public registration. Chartered corporations, created by executive act, are spoken of in the English reports as corporations at common law, and are contrasted with statutory corporations.

The right to be and act as a corporation, and to enjoy the privileges and immunities resulting from incorporation, is a franchise, and a corporation, therefore, cannot be created except by or under special authority from the state.¹⁴ For this reason, a corporation has sometimes been defined as a "franchise." Thus, Chancellor Kent said in his Commentaries: "*A corporation is a franchise* possessed by one or more individuals, who subsist, as a body politic, under a special denomination, and are vested, by the policy of the law, with the capacity of perpetual succession, and of acting in several respects, however numerous the association may be, as a single individual."¹⁵

This, however, is inaccurate. A corporation is not a franchise, but the consequence of a franchise. *The right to be and act as a corporation* is a franchise, and when this franchise is granted by the state to a body of men, and accepted by them, it creates an artificial person, having an individuality, in contemplation of the law, distinct from the men who compose it. This artificial person, the result of the franchise, is the corporation.

In addition to the franchise to be and act as a corporation, there are certain other privileges or franchises which cannot be exercised except by special authority from the state. Among these are the privilege of maintaining a ferry, bridge, or road, to the exclusion of others, and taking tolls, the right to exercise the power of eminent domain, the right to exercise banking privileges by issuing notes to circulate as money,¹⁶ the right to construct waterworks by

¹⁴ Post, §§ 9, 19; *Spring Valley Water Works v. Schottler*, 62 Cal. 69, aff'd 110 U. S. 347, 28 L. Ed. 173, 4 Sup. Ct. 48; *People v. Ford Motor Co.*, 188 Cal. 8, 204 Pac. 217; *Union Steam Pump Sales Co. v. Secretary of State*, 216 Mich. 261, 185 N. W. 353; *Turner v. Goetz*, 184 Wis. 508, 199 N. W. 155.

In the case of corporations *de facto* the consent of the sovereign seems to be impliedly rather than expressly given, by a general consent to that kind of corporation, even though the conditions of incorporation are not substantially complied with. See *infra*, Sec. 19.

¹⁵ 2 Kent's Com. 267. See, also, *Comyn's Dig. "Franchise"* (F) F 1; 1 Bl. Com. 123; *Gifford v. Livingston*, 2 Denio (N. Y.) 380. See *Taylor, Corporations* (5th Ed.), sec. 23.

¹⁶ See *People v. Utica Ins. Co.*, 15 Johns. (N. Y.) 353, 8 Am. Dec. 243. The right to exercise the privilege of banking is not a franchise at common law, except as to the privilege of issuing notes to circulate as money, and it has been held in some jurisdictions that the legislature cannot make it a franchise, except as to such privilege. See *State v. Scougal*, 3 S. D. 55,

laying pipes in the streets of a city, and to collect rates for furnishing water to the city and its inhabitants, etc.¹⁷

The franchise to be a corporation belongs to the members in their individual capacities, and not to the corporation itself.¹⁸ The secondary or additional franchises and privileges conferred upon a corporation,—that is, the powers and privileges other than the mere franchise of being a corporation,—belong to the corporate body as such, and not to the members in their individual capacity; they “are the franchises of the corporation.”¹⁹

The franchise *to do* was not at first clearly distinguished from the franchise *to be*, because corporations were specially created for the promotion of some public purpose. But it is well established that legal personality, like the grant of secondary franchises, is a gift lying in the discretion or favor of the state, and subject to whatever reasonable conditions and restrictions the state may choose at the time of granting it to impose. Since corporations enjoy special privileges granted by the state, they come under special regulations and liabilities. “Nor is this any the less so because most of our corporations obtain their personality by mere compliance with the simple formalities prescribed in a general act. . . . It does not seem that corporate personality is any the less the gift of the state merely because the state prescribes in general terms the conditions upon which it is to be granted.”²⁰ There are however those who contest the soundness of the view that in the modern law incorporation should be regarded as a special privilege or franchise granted by the favor of the state, which can

51 N. W. 858, 15 L. R. A. 477, 44 Am. St. Rep. 756; First State Bank of Oklahoma City v. Lee, 65 Okla. 280, 166 Pac. 186.

¹⁷ Spring Valley Water Works v. Schottler, 62 Cal. 69, aff'd 110 U. S. 347, 28 L. Ed. 173, 4 Sup. Ct. 48.

¹⁸ State v. Georgia Medical Society, 38 Ga. 608, 95 Am. Dec. 408; Fietsam v. Hay, 122 Ill. 293, 13 N. E. 501, 3 Am. St. Rep. 492; Memphis & L. R. R. Co. v. Board of Railroad Com'rs, 112 U. S. 609, 28 L. Ed. 837, 5 Sup. Ct. 299; Union Steam Pump Sales Co. v. Secretary of State, 216 Mich. 261, 185 N. W. 353.

But see Bank of California v. San Francisco, 142 Cal. 276, 75 Pac. 832, 64 L. R. A. 918, 100 Am. St. Rep. 130. The right to be and exist as a corporation is a grant from the

state known as the corporate franchise. If this corporate franchise is assessable as property, it must be assessed to the corporation, instead of to the members or stockholders.

¹⁹ Memphis & L. R. R. Co. v. Board of Railroad Com'rs, 112 U. S. 609, 28 L. Ed. 837, 5 Sup. Ct. 299. See Lord v. Equitable Life Assur. Soc. of U. S., 194 N. Y. 212, 225, 226, 87 N. E. 443, 22 L. R. A. (N. S.) 420. “They are no part of the corporate life, if owned by a corporation any more than they are part of individual life if owned by a human being.”

²⁰ H. A. Smith, Law of Associations, p. 137. Cf. Carr, Corporations (1905) p. 174. Machen, 24 Harvard Law Rev. 361.

accordingly dictate terms and impose special restrictions, regulations and taxes upon those doing business in the corporate form.²¹

§ 4. Corporations distinguished from partnerships and unincorporated associations.—It is difficult to find what peculiar powers or privileges can only be possessed by corporations or associations which must be regarded as incorporated or personified. A common name, the capacity of succession or continuity of organization, and transferable shares may be enjoyed by joint stock companies at common law. The separate capacity or personality by which the affairs of the group are separated from those of the members is the essential attribute. The privilege of limited liability is not an essential characteristic of a corporation, as stockholders may be made personally liable for the corporate debts very much like partners.

Corporation contrasted with partnership.—The firm of A & Co. is not regarded as a separate entity or person from A, B, C and D who compose it.²² The property of the firm belongs to the members and may be levied on for their individual debts. The A corporation however is an entirely different person from Mr. A, even though he organized it, manages it and owns practically all the stock. He may contract with the corporation and his property cannot be taken for the debts of the corporation or *vice versa*. Each partner is an agent of the firm to make contracts incident to its business; a shareholder is not as such an agent of the corporation; the liability of a partner for the debts of the firm is unlimited; that of the shareholder is usually limited to paying the par value of the stock subscribed.

²¹ Morawetz, Corporations (2nd ed.), secs. 922, 923; Machen, Corporations, secs. 3, 19; 24 Harvard Law Review, 361. See *State v. Western Irrigating Canal Co.*, 40 Kan. 96, 19 Pac. 349, 10 Am. St. Rep. 166. In spite of what these learned authorities say, it seems clearly desirable to retain the concept that the grant of corporate capacity is a franchise which entails liability to public regulation. Vast aggregations of capital, like the United States Steel Corporation and the Standard Oil Co., exercise great economic power. The employment of large capital is a matter of public concern. It is important to exercise control over corporations to protect the public

and also investors and the interests of the stockholders which are entrusted to officers and directors. Public policy demands the power to superintend and control big business generally. It is, therefore, fortunate that incorporation should be regarded as the grant of a franchise or special privilege conferred by the state upon such conditions as it may see fit to impose.

²² See *In re Gibbs' Estate*, 157 Pa. St. 59, 27 Atl. 383, 22 L. R. A. 276; *Hoadley v. Essex County Com'rs*, 105 Mass. 519; *Francis v. McNeal*, 228 U. S. 695, 57 L. Ed. 1029, 33 Sup. Ct. 701, L. R. A. 1915 E 706; *Abbott v. Anderson*, 265 Ill. 285, 106 N. E. 782, L. R. A. 1915 F

Where a question arises in one state or country as to whether an association of persons under the laws of another state or country is a corporation or merely an unincorporated association, the question depends upon the nature of the association, and the powers and faculties conferred upon it. If these are such as to make it a corporation, it will be held to be a corporation, even though the foreign statutes under which it was created or authorized may expressly declare that it shall not be deemed a corporation. "Whatever may be the effect of such a declaration in the courts of that country, it cannot alter the essential nature of a corporation or prevent the courts of another jurisdiction from inquiring into its true character, whenever that may come in issue."²³

Capacity to act as an artificial person.—The attribute which is characteristic of a corporation, and essential to corporate existence, is the capacity to act as an entity, being, or person in the law, distinct and apart from the members who compose it. As has been explained in previous sections, a corporation is regarded as an artificial person, or legal entity distinct from its members, for the purpose of contracting, or taking, holding, and conveying property, of suing and being sued, and for many other purposes. "A corporation is a legal person just as much as an individual; and if a man trusts a corporation, he trusts the legal person, and must look to its assets for payment: he can only call upon the individual members to contribute in case the act or charter so provides."²⁴

This merging of the individual members of a corporation into one body, so as to create an artificial person, is the most important feature of a corporation, and the feature which, above all others, distinguishes it from associations of individuals who are not incorporated.²⁵ Even a one man company is legally distinct in its rights and liabilities from the man who owns or controls all the stock

668; *Crane*, 28 *Harvard Law Rev.* 762, 766. Cf. *Lewis*, 29 *Harvard Law Rev.* 158, 166; 22 *Harvard Law Rev.* 393; 20 *Harvard Law Rev.* 589.

²³ *Liverpool & London Life & Fire Ins. Co. v. Massachusetts*, 10 *Wall. (U. S.)* 566, 19 *L. Ed.* 1029. See also, *Edgeworth v. Wood*, 58 *N. J. Law*, 463, 33 *Atl.* 940. Compare *Edwards v. Warren Linoline & Gasoline Works*, 168 *Mass.* 564, 47 *N. E.* 502, 38 *L. R. A.* 791; *American Ry. Exp. Co. v. Commonwealth*, 190 *Ky.* 636, 228 *S. W.* 433.

See *Machen, Corporate Personality*, 24 *Harv. Law Rev.* 351.

²⁴ *In re Sheffield & S. Yorkshire P. Bldg. Soc.*, 22 *Q. B. D.* 476. The corporate idea is to personify the group as an entity, with a separate capacity which owns the property and owes the debts.

²⁵ See *Thomas v. Dakin*, 22 *Wend. (N. Y.)* 9; *Hamilton v. Young*, 116 *Kan.* 128, 225 *Pac.* 1045, 35 *A. L. R.* 496; *Salomon v. Salomon & Co.*, [1897] *A. C.* 22, 436.

and who is alone concerned in the enterprise. By incorporation that enterprise and its capital and dealings are separated off from the other affairs of its owners. Suppose however, that A and B are in partnership as drygoods merchants. A and B in this association have a group of legal relations and business activities which they need to keep separate and distinct from their other affairs. A may also be engaged in the coal business by himself or with others. So may B. Each carries on business which has nothing to do with their mutual business as drygoods merchants. But the law does not recognize the firm or partnership as a separate entity or person, and confusion may result.²⁶

Corporate name.—It would be obviously impossible for a corporation to contract, or to take and convey property, or to sue or be sued as such, unless it had a name in which to do so, and therefore a corporate name of some kind is necessary.²⁷

Capacity of succession.—One of the principal objects of incorporation is to create a continuing entity²⁸ which shall have the capacity of existing either perpetually or for a fixed period, notwithstanding the death or withdrawal of the members who compose it. This is an essential attribute of a corporation, and is necessary to accomplish the various objects for which corporations are created.²⁹

In modern business corporations, the membership is determined by the ownership of shares of stock. When a stockholder withdraws and transfers his stock, the transferee becomes a member in his place. If a stockholder dies, the person who becomes the owner of the stock succeeds him as a member of the corporation. None of these changes in the slightest degree affect either the existence or the identity of the corporation as a legal body and arti-

²⁶ See W. D. Lewis, *The Uniform Partnership Act*, 29 *Harvard Law Rev.* 158. The separate grouping of activities carried on as a separate enterprise is the idea back of the corporate entity.

²⁷ In some jurisdictions an unincorporated labor union may sue and be sued by its name as if it were an entity, yet it is not a corporation. *United Mine Workers of America v. Coronado Coal Co.*, 259 U. S. 344, 66 L. Ed. 975, 42 Sup. Ct. 570, 27 A. L. R. 762.

²⁸ As to the meaning of the obscure phrase "perpetual succes-

sion," see *State ex rel. Allison v. Hannibal & Ralls County Gravel Road Co.*, 138 Mo. 332, 39 S. W. 910, 36 L. R. A. 457.

Taylor, Corporations (5th ed.), sec. 16.

²⁹ *Thomas v. Dakin*, 22 Wend. (N. Y.) 9. But see *Andrews Bros. Co. v. Youngstown Coke Co.*, 86 Fed. 585, 589.

"The only absolutely essential attribute of a corporation is the capacity to exist and act within the powers granted, as a legal entity, apart from the individual or individuals who constitute its members."

ficial person. It continues as before, and may continue as the same corporation, through any number of changes, and for any length of time, unless its charter limits the period of its existence. It is, as was said by Blackstone, "a person that never dies; in like manner as the River Thames is still the same river, though the parts which compose it are changing every instant."³⁰

Transfer of membership.—As an incident to modern business corporations, the shares therein are transferable by the holders without the consent of the other holders, or of the corporation, and when a share is transferred the transferee becomes a member of the corporation in the place of the transferrer. Unincorporated joint stock companies and business trusts also frequently issue transferable certificates of shares of beneficial interest, so that this is not an exclusive corporate privilege.

Exemption of members from liability for debts.—One of the most valuable incidents of a corporation is that the members are not individually liable for its debts beyond the amount of their respective subscriptions to the capital. The property of a corporation may be subjected to the payment of its debts, and the members may thus lose what they have put into the corporation, but beyond this, at common law, they are not liable upon fully paid up stock. This important incident of a corporation has sometimes been referred to as an essential characteristic, but it is not necessarily so at all. The legislature may make the stockholders or members of a corporation personally liable for its debts to a greater or less extent, and in some jurisdictions such statutes have been enacted. Such liability on the part of the members does not make the body any the less a corporation.³¹

³⁰ 1 Bl. Com. 468.

An unincorporated joint stock association is like a corporation in having the feature of "perpetual succession." In re Jones' Estate, 172 N. Y. 575, 65 N. E. 570, 60 L. R. A. 476.

In re Pittsburg Wagon Works' Estate, 204 Pa. 432, 54 Atl. 316. The retirement or death of a member works no dissolution as in a partnership. The interest of the members is made transferable.

³¹ Warner v. Beers, 23 Wend. (N. Y.) 103; People ex rel. Winchester v. Coleman, 133 N. Y. 279, 31 N. E. 96, 16 L. R. A. 183.

Limited liability results without specific mention as a consequence of the separate corporate capacity in which the corporation incurs liability. Stockholder's individual liability for corporate debts when stock is full paid must be superadded by statute. United States v. Stanford, 161 U. S. 412, 429, 40 L. Ed. 751, 16 Sup. Ct. 576.

By-laws.—The power to make by-laws for the conduct of the corporate business is one of the incidents of corporate existence. They will usually provide for the time, place and notice of the annual meeting of the stockholders; the calling of special meetings; what percentage constitutes a quorum; the mode of voting by proxies; the time, place and notice of regular directors' meetings; what number shall constitute a quorum; the executive officers, their duties, compensation, election and removal; the signing of checks and stock certificates; the fiscal year of the company, and other matters. By-laws are usually made by the stockholders, but sometimes the power is delegated to the directors. By-laws frequently provide how contracts shall be authorized and executed.

Joint stock companies.—It is often very difficult to distinguish between a corporation and a modern unincorporated joint-stock company, since, under the statutes, they possess many common features. An unincorporated joint-stock company is an association of individuals for the purpose of profit, having a capital divided into shares which are transferable by the owner.³² Such associations may be formed by mere contract between the members and do not require special legislative authority or franchise. At common law an unincorporated association for the purpose of carrying on business is simply a large partnership. Such a company must sue and be sued in the names of its individual members however numerous they may be and they are jointly liable for the debts.³³ In some states joint stock companies have extensive stat-

³² *People ex rel. Winchester v. Coleman*, 133 N. Y. 279, 31 N. E. 96, 16 L. R. A. 183; *In re Gibbs' Estate*, 157 Pa. St. 59, 27 Atl. 383, 22 L. R. A. 276; *Phillips v. Blatchford*, 137 Mass. 510; *Attorney General v. Mercantile Marine Ins. Co.*, 121 Mass. 524; *Edwards v. Warren Linoline & Gasoline Works*, 168 Mass. 564, 47 N. E. 502, 38 L. R. A. 791. See *Haiku Sugar Co. v. Johnstone*, 249 Fed. 103.

In *Spotswood v. Morris*, 12 Idaho 360, 85 Pac. 1094, 6 L. R. A. (N. S.) 665, it was held that an unincorporated association may be formed for the purchase of a tract of land, title to be taken in a trustee, who may issue transferable certificates of stock and which may provide that the death of a shareholder shall not dissolve the company, and that neither officers

or shareholders shall sell or dispose of the property without the concurrence of all the members. Such an association does not have or exercise any of the powers or privileges of a corporation not possessed by individuals at common law.

³³ *Roberts v. Anderson*, 226 Fed. 7. Unincorporated labor unions, such as the United Mine Workers having over 400,000 members in its local unions, are suable in their common names in the federal courts to subject their funds to liability for torts committed by authority of such unions in strikes. Ordinarily, however, an unincorporated association cannot sue or be sued in its common name, except by statute. *United Mine Workers of America v. Coronado Coal Co.*, 259 U. S. 344, 66 L. Ed. 975, 42 Sup. Ct. 570, 27 A. L. R. 762, 786; *Taff Vale*

utory powers conferred upon them by the state. The great express companies prior to the recent consolidation were organized as statutory joint stock companies. They enjoyed most of the attributes and powers of corporations. Such statutes are found in New York, Pennsylvania and Michigan. For some purposes they may be treated as partnerships,³⁴ and for others as quasi-corporate entities.³⁵

In *Hibbs v. Brown*,³⁶ the New York court held that the bonds of the Adams Express Company, organized as a statutory joint stock company, were negotiable notwithstanding that they were made payable solely out of the joint assets, with no personal liability on the part of the individual shareholders, from which it was argued that they were not issued on the general credit of the maker as required in a negotiable instrument.

Continuity of existence.—An ordinary common-law partnership is dissolved by the death or withdrawal of a member. This is so even when a member transfers his interest in the firm with the consent of his partners, and the person to whom he sells is taken into the firm in his place. The existence and the identity of the firm is affected. The old partnership is dissolved, and a new part-

R. Co. v. Amalgamated Soc. (1901) A. C. 426, 1 B. R. C. 832.

³⁴ Great Southern Fire Proof Hotel Co. v. Jones, 177 U. S. 449, 44 L. Ed. 842, 20 Sup. Ct. 690. *Edwards v. Warren Linoline & Gasoline Works*, 168 Mass. 564, 47 N. E. 502, 38 L. R. A. 791. A Pennsylvania partnership association cannot be sued as a legal entity in Massachusetts, although clothed at home with most of the features and powers of a corporation.

In *People ex rel. National Exp. Co. v. Coleman*, 133 N. Y. 279, 31 N. E. 96, it is held that the *National Express Company*, a joint stock company was not taxable under the statute taxing corporations. The company was formed in 1853 as a joint stock company or association by written agreement between eight individuals. Statutes enacted at various times gave such companies various privileges, such as power to sue in the name of an officer, power to issue transferable shares, and most of the corporate facilities except that of limited liability. The legislation left them a joint stock company. Cf. *Express Co. v. State*, 55 Ohio St. 69, 78, 44 N. E. 506.

³⁵ *Roberts v. Anderson*, 226 Fed. 7; *Gifford v. Fargo*, 106 Misc. 599, 176 N. Y. S. 568.

In Michigan partnership associations limited are governed by the principles applicable to corporations. *Goodspeed v. Wayne Circuit Judge*, 199 Mich. 273, 165 N. W. 943; *Staver v. Blake*, 111 Mich. 282, 69 N. W. 508, 38 L. R. A. 798.

Wrightington, Unincorporated Ass'ns (2nd Ed.), § 9; *Eliot v. Freeman*, 220 U. S. 178, 55 L. Ed. 424, 31 Sup. Ct. 360; *Hecht v. Malley*, 265 U. S. 144, 68 L. Ed. 949, 44 Sup. Ct. 462; *Rottschaefer*, 25 Columbia Law Rev. 305, 313.

³⁶ *Hibbs v. Brown*, 190 N. Y. 167, 82 N. E. 1108, "So many of the attributes and characteristics of a corporation have been impressed upon the modern joint stock association that in my opinion, for the purposes of the question now before us, (the negotiability of an express company's bond) we are amply justified in regarding simply the joint, quasi corporate entity." The plaintiff failed in an action to recover coupons on bonds stolen from him and sold to an innocent purchaser for value.

nership is formed. In the case of a corporation, by reason of the capacity of succession, it is very different. If a member dies or withdraws, neither the existence nor the identity of the corporation is in the least affected. This feature of a corporation, however, cannot always be relied upon as a distinguishing mark, for it may be adopted as an article of partnership. In forming a partnership or joint stock company, the members may stipulate in their agreement that persons to whom they may transfer their shares shall come into the firm, and that, on the death of a member, the partnership shall not be dissolved, but his heir or personal representative shall become a member in his stead.³⁷

The distinction between a corporation and an ordinary partnership or an unincorporated joint-stock company, with respect to individual liability of the members, may be stated thus: The members of a corporation are not individually liable for the debts of the corporation, unless the legislature imposes such liability; but the members of a partnership or unincorporated joint-stock company are individually liable for its debts, unless their liability is expressly limited by legislative enactment, or by a contract with the creditors.³⁸ Since stockholder's liability is frequently imposed for corporate debts, it is obvious that the exemption of the members of an association from individual liability cannot be relied upon as a test for determining whether the association is a corporation.³⁹

Business trusts.—The attempt has been made in recent years to devise a form of organization, often called Massachusetts trusts or business trusts, which shall give most of the advantages of incorporation without the legislative grant of corporate privileges, and without submitting to the taxation and regulation imposed on corporations. There is still great uncertainty as to how far exemption from individual liability as partners can be thus secured, particularly if the shareholders retain any power of control.⁴⁰

³⁷ Warner v. Beers, 23 Wend. (N. Y.) 103; Hoadley v. Essex County Com'rs, 105 Mass. 519; Gleason v. McKay, 134 Mass. 419; Philips v. Blatchford, 137 Mass. 510; Carter v. McClure, 98 Tenn. 109, 38 S. W. 585, 36 L. R. A. 282, 60 Am. St. Rep. 842.

³⁸ People ex rel. Winchester v. Coleman, 133 N. Y. 279, 31 N. E. 96, 16 L. R. A. 183. And see Warner v. Beers, 23 Wend. (N. Y.) 103.

³⁹ But in People ex rel. Winchester v. Coleman, 133 N. Y. 279, 31 N. E. 238, however, the court emphasizes

unlimited liability on the members of a joint stock company, existing without the aid of any statute imposing it, as conclusive that the company was not a corporation. See Warner v. Beers, 23 Wend. 103.

⁴⁰ Thompson v. Schmitt, 115 Tex. 53, 274 S. W. 554, noted 39 Harvard Law Review, 276; Betts v. Hackathorn, 159 Ark. 621, 252 S. W. 602, 31 A. L. R. 847, 851 note.

See Wrightington, Unincorporated Associations, § 14; Magruder, "The position of shareholders in business

The Home Lumber Company brought suit in Kansas in mandamus to compel the Blue Sky Board to consider an application for permission to sell stock and certificates of a business trust in the State of Kansas. The plaintiff, an unincorporated association, was organized under a declaration of trust. The question arises whether the declaration created a partnership. By the declaration of trust, the organizers transfer to trustees certain property and the trustees are to issue negotiable certificates of shares. They engaged to use the capital and the proceeds of the shares sold in general manufacturing, mercantile, or commercial business. They were authorized to deal in all kinds of property and to carry on all kinds of business not inconsistent with law. It was provided that the trustees should be elected annually by the share holders at their meeting, and vacancies should be filled by the remaining trustees. The trustees were to have the exclusive management and control of the property and agreed to hold the shareholders exempt from liability upon any contract.

The trustees were given power to make and amend by-laws, elect officers, appoint agents, and fix their own compensation. The death of a shareholder, it was provided, should not terminate the trust. The ownership of shares was not to entitle the shareholder to any title to the trust property or any voice or control in the management of the property or business connected therewith. The trustees were to have no power to bind the shareholders personally. It was to be the duty of the trustees to stipulate that neither the trustees nor the shareholders should be held for any personal liability, but that persons contracting with the trust should look only to the funds and property of the trust. The trustees were to pay dividends at their discretion and make distributions of the assets among the shareholders at the end of 20 years.

It was held that this agreement created a trust and not a partnership, and that the shareholders could not be held individually liable for the obligations of the trustees. The sale of shares in the trust was not the "doing of business" within the state. It was held to be the duty of the state charter board to consider the application of the trust for permission to sell shares in Kansas.⁴¹

trusts," 23 Columbia Law Review, 423, 429; Cook, 9 American Bar Assn. Journal, 763; Magruder, 35 Harvard Law Review, 923.

⁴¹ Home Lumber Co. v. Hopkins,

107 Kan. 153, 161, 190 Pac. 601, 605, 10 Am. L. Rep. 879.

See also Notes on Massachusetts Trusts in 7 Am. L. Rep. p. 612; 31 Am. Law Rep. 851; 29 Yale L. Jour.

Under a constitutional provision, such as is found in several states, that the term "corporations" shall include all associations and joint stock companies having powers and privileges not possessed by individuals or partnerships; and that all corporations may sue and be sued in their corporate name, it has been held that a Massachusetts trust is a corporation which may sue and be sued as a legal entity, and is subject to the Blue Sky Law as to the issue of its securities.⁴² In some states it is not permitted to secure to those associated under a trust agreement the advantages of corporations, with freedom from the restrictions and regulations imposed upon corporations.^{42a}

§ 5. Consequences of separate corporate entity.—Corporate personality expresses the idea of a separate capacity in which contracts are made, property is held, conveyances are made, suits are brought. The separation of capacities may be also observed in matters of set-off or counterclaim, in questions of taxation, and in corporations controlled by the government or by a parent corporation.

Separate corporate entity.—If A, B and C are incorporated into the A. B. C. Company, the stockholders are of course the holders of the rights and liabilities arising from transactions of the company. But they hold them in their corporate capacity.⁴³ The legal

nal, 879, 27 Yale L. J. 677; 23 Columbia L. Rev. 373, 423; 33 Harvard Law Rev. 705, 35 Id. 923, 12 Cornell Law Quart. 198.

⁴² Massachusetts Trust as a corporation. See *Harris v. United States Mexico Oil Co.*, 110 Kan. 532, 204 Pac. 754. (Service by publication may be made on a Massachusetts trust in its collective name as a foreign corporation.)

Hamilton v. Young, 116 Kan. 128, 225 Pac. 1045, 35 A. L. R. 496. Massachusetts trust is a corporation to the extent that it is a legal entity which may act on its own account through officers. *Weber Engine Co. v. Alter*, 120 Kan. 557, 245 Pac. 143, Massachusetts trust can only transact business within the state of Kansas by conforming to regulations imposed by statute upon corporations. *Reilly v. Clyne*, 27 Ariz. 432, 234 Pac. 35, 40 A. L. R. 1005.

^{42a} *Weber Engine Co. v. Alter*, 120 Kan. 557, 245 Pac. 143; *State ex rel.*

Range v. Hinkle, 126 Wash. 581, 219 Pac. 41; (no legal standing as a suable entity) *Spotswood v. Morris*, 12 Idaho 360, 85 Pac. 1094, 6 L. R. A. (N. S.) 665. See *Denny v. Cascade Platinum Co.*, 133 Wash. 436, 232 Pac. 409. See 12 Cornell Law Quart. 198.

⁴³ The general doctrine is well established that a corporation is a legal entity distinct from its individual members or stockholders, and that the property or rights acquired or the liabilities incurred by the corporation, are the property, rights, and liabilities of such legal entity as distinguished from the members who compose it. *Donnell v. Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 52 L. Ed. 481, 28 Sup. Ct. 288; *Peterson v. Chicago, R. I. & P. Ry. Co.*, 205 U. S. 364, 51 L. Ed. 841, 27 Sup. Ct. 513; *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 382, 37 L. Ed. 1113, 14 Sup. Ct. 127; *Pullman's Palace Car Co. v. Missouri Pac. Ry.*

relations created in this capacity are regarded as if the corporation were itself a separate and distinct person, owning property and acting through its directors and other representatives. The stockholders in their individual capacity cannot bind the corporation or transfer its property. Nor are they personally liable upon its debts or contracts.^{43a}

A contract by the corporators or stockholders of a corporation, as such, either before or after incorporation, and not as the authorized agents of the corporation, is not the contract of the corporation, and is not binding upon it, unless adopted.⁴⁴ So the stockholders and officers are not bound personally by contracts made in the name of the corporation, as by an agreement upon the sale of the good will of a business not to compete. When a corporation makes a contract it is a contract of the legal entity, and not of the individual members, and only binds them as a corporation.⁴⁵ An action must be brought by or against the corporation and not by or against the stockholders as individuals.

Co., 115 U. S. 587, 29 L. Ed. 499, 6 Sup. Ct. 194; *Macon Exch. Bank v. Macon Const. Co.*, 97 Ga. 1, 25 S. E. 326, 33 L. R. A. 800. 14 C. J. p. 52, § 3.

In *Donnell v. Safe Co.*, supra, the Supreme Court, speaking through Mr. Justice Holmes, said:

"Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships, and other groups into a single conception. But to generalize is to omit, and in this instance to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and law. A leading purpose of such statutes and of those who act under them is to interpose a non-conductor, through which, in matters of contract, it is impossible to see the men behind." But to this general rule there are certain exceptions.

^{43a} In *Salomon v. Salomon & Co. Ltd.* [1897] A. C. 22; it was contended by creditors and held by the Court of Appeal that Salomon was personally liable for the debts of the company, as if it were his individual agent. But in the House of Lords, Lord Herschell said, "a company may in every case be said to carry on

business for and in behalf of its shareholders, but this certainly does not in point of law constitute the relation of principal and agent between them, or render the shareholders liable to indemnify the company against the debt which it incurs."

⁴⁴ *Moore & Handley Hardware Co. v. Towers Hardware Co.*, 87 Ala. 206, 6 So. 41, 13 Am. St. Rep. 23; *Sellers v. Greer*, 172 Ill. 549, 50 N. E. 246, 40 L. R. A. 589. See 15 Mich. Law Rev. 264.

A contract by competing firms dividing their territory does not bind a corporation formed by members of one of the firms, at least in the absence of a showing that the corporation was fraudulently created as a device to evade their personal obligations as individuals. See *Beale v. Chase*, 31 Mich. 490; *George v. Rollins*, 176 Mich. 144, 142 N. W. 337.

⁴⁵ A contract by a corporation not to engage in business in competition with one to whom it has sold its good will is not binding upon its individual stockholders and officers, but only on the corporation itself. *Hall's Safe Co. v. Herring-Hall-Marvin Safe Co.*, 146 Fed. 37, 14 L. R. A. (N. S.) 1182; *Donnell v. Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 52 L. Ed. 481, 28 Sup. Ct. 288.

Title in corporate entity.—When a corporation takes a conveyance or otherwise acquires property, the title vests in it as a legal entity distinct from its members, and not in its members.⁴⁶ In an English case, in which this principle was applied, the custom-house officers refused to register a vessel belonging to a British corporation, on the ground that some members of the corporation were foreigners, and the statute allowed the registry of such vessels only as belonged wholly to British subjects. On *mandamus* proceedings to compel the officers to register the vessel, it was held that, as it belonged to a British corporation, and not to the members thereof, it was entitled to registry. "The individual members of the corporation, no doubt," said Lord Denman, "are interested in one sense in the property of the corporation, as they may derive individual benefit from its increase, or loss from its destruction; but in no legal sense are the individual members the owners."⁴⁷

⁴⁶ Reg. v. Arnaud, 16 Law J. Q. B. (N. S.) 50; Parker v. Bethel Hotel Co., 96 Tenn. 252, 34 S. W. 209, 31 L. R. A. 706; Buffalo Loan, Trust & Safe Deposit Co. v. Medina Gas Co., 162 N. Y. 67, 56 N. E. 505; Automobile Mortgage Co. v. Ayub, — Tex. Comm. App. —, 266 S. W. 134; 8 Minn. Law Rev. 251; 9 Minn. Law Rev. 382. Until dissolution the corporation is the owner of the entire title, legal and equitable, of all the corporate property.

In *Macaura v. Northern Assurance Co.* [1925] A. C. 619 the House of Lords has held that the plaintiff who was a creditor of and the sole shareholder in a corporation had no insurable interest in the property of the corporation and could not recover on policies taken in his own name.

Compare *Riggs v. Commercial Mut. Ins. Co.*, 125 N. Y. 7, 25 N. E. 1058, 10 L. R. A. 684, 21 Am. St. Rep. 716.

See criticism of the English view in 21 Illinois Law Review, 40.

⁴⁷ Reg. v. Arnaud, 16 Law J. Q. B. (N. S.) 50. On the same principle, the fact that members of a domestic corporation are aliens, and that aliens cannot hold land, will not prevent the corporation from acquiring and holding land. *Princeton Min. Co. v. Butte First Nat. Bank*, 7 Mont. 530.

But the state may forbid aliens ineligible to citizenship to acquire shares of stock in any corporation that may be authorized to hold land,

and thus forbid indirect as well as direct ownership and control of land by aliens, unless some treaty otherwise provides. *Frick v. Webb*, 263 U. S. 326, 68 L. Ed. 323, 44 Sup. Ct. 115.

The California statute forbids any corporation or association to acquire, use or transfer real property, when the majority of the members are ineligible aliens, except as prescribed by treaty. In the absence of treaty provision the state may regulate the holding of realty by aliens. 12 California Law Rev. 259; 10 Ibid. 497.

In *Rhode Island Hospital Trust Co. v. Doughton*, 270 U. S. 69, 46 Sup. Ct. 256, Taft, C. J., said: "The question here presented is whether North Carolina can validly impose a transfer or inheritance tax upon shares of stock owned by a non-resident in a business corporation of New Jersey, because the corporation does business and has two-thirds of its property within the limits of North Carolina. We think that the law of North Carolina, by which this is attempted, is invalid. It goes without saying that a state may not tax property which is not within its territorial jurisdiction. *State Tax on Foreign Held Bonds*, 15 Wall. 300, 21 L. Ed. 179. . . . In the matter of intangibles, like choses in action, shares of stock, and bonds, the situs of which is with the owner, a transfer tax, of

Conveyances and mortgages.—Since the property of a corporation belongs to the corporation, as distinguished from its members, it must be conveyed by the corporation in the corporate name, and not by the members individually or collectively. When the title to land is in a corporation, a conveyance by the members of the corporation in their own names will not be effectual, even though all may join in it.⁴⁸ It follows that a mortgage by a corporation must be executed in the corporate name, and not by the members individually. If it is executed by the members of the corporation in their own names merely, although all the members may join, and although they may intend to bind the corporation, it is not a valid legal mortgage.⁴⁹

A Maryland case, *Swift v. Smith*,⁵⁰ involved the validity of a mortgage given by C upon corporate property. C owned all the

course, may be properly levied by the state in which he resides. So, too, it is well established that the state in which a corporation is organized may provide, in creating it, for the taxation in that state of all its shares, whether owned by residents or nonresidents. *Hawley v. City of Malden*, 232 U. S. 1, 12, 58 L. Ed. 477, 34 Sup. Ct. 201, Ann. Cas. 1916C 842. . . . In this case the jurisdiction of North Carolina rests on the claim that because the New Jersey corporation has two-thirds of its property in North Carolina, the state may treat shares of its stock as having a situs in North Carolina to the extent of the ratio in value of its property in North Carolina to all of its property. This is on the theory that the stockholder is the owner of the property of the corporation, and the state which has jurisdiction of any of the corporate property has *pro tanto* jurisdiction of his shares of stock. We cannot concur in this view. The owner of the shares of stock in a company is not the owner of the corporation's property. He has a right to his share in the earnings of the corporation, as they may be declared in dividends, arising from the use of all its property. In the dissolution of the corporation he may take his aliquot share in what is left, after all the debts of the corporation have been paid and the assets are divided in accord-

ance with the law of its creation. But he does not own the corporate property."

⁴⁸ *Wheelock v. Moulton*, 15 Vt. 519; *Parker v. Bethel Hotel Co.*, 96 Tenn. 252, 34 S. W. 209, 31 L. R. A. 706; See, also, *Baldwin v. Canfield*, 26 Minn. 43, 1 N. W. 261, 276; *Humphreys v. McKissock*, 140 U. S. 304, 35 L. Ed. 473, 11 Sup. Ct. 779; *Rough v. Breitung*, 117 Mich. 48, 75 N. W. 147; *Sellers v. Greer*, 172 Ill. 549, 50 N. E. 246, 40 L. R. A. 589. See 15 Michigan Law Rev. 264.

In *Parker v. Bethel Hotel Co.*, 96 Tenn. 255, 34 S. W. 209, 31 L. R. A. 706, F. became the sole owner of all of the stock of the Hotel Co., a corporation. He executed a deed to W. by which he purported to convey the company's land in his own name. In a suit to annul this deed, it was held that the grantee took nothing by the deed. The corporation and its shareholders are distinct legal persons. The fact that F. owned all the stock makes no difference. The title could only be conveyed by the company in its corporate name.

⁴⁹ *Bundy v. Ophir Iron Co.*, 38 Ohio St. 300. But see *Machen on Corporations*, sec. 1293; 15 Mich. Law Rev. 264.

⁵⁰ In *Swift v. Smith*, 65 Md. 428, 5 Atl. 534, 57 Am. Rep. 336, the doctrine was announced that the sole owner of the capital stock of a corporation was in equity the owner

stock of the company. The mortgage was given partly to secure a debt of the corporation and partly to secure a personal debt of C's for stock purchased. The mortgage was signed by C under his own seal and by S as president on behalf of the corporation. It was objected by another creditor that the signature of the president was not countersigned by the secretary, and that the debt was *ultra vires* as being outside the proper course of the business of the company. The court held that even if the execution of the mortgage by the company was void, the mortgage by C, the sole stockholder, was good irrespective of the attempted execution by the company. Being the absolute proprietor in equity of all that belonged to a purely private enterprise, his act in charging its property for loans to and claims against the corporation and, also, for his purchase of stock in it, is effective without bringing in other persons to do it in a corporate way. He could conduct the corporation as an individual without corporate formalities. The claim of a subsequent creditor of the corporation after re-issue of stock to new members is subordinate to the lien of the mortgage.

If the sole owner of all the stock can convey the corporate property by his deed or mortgage, it would seem that all the stockholders of a corporation, however numerous, could do the same by their joint deed. It has been said, however, that the only way the business of a corporation can regularly be carried on by the sole shareholder without corporate formalities would be after a formal dissolution and winding up of the corporation.⁵¹

Rights of action.—On the same principle, members of a corporation cannot in their own names maintain an action of replevin or ejectment to recover possession of property belonging to the corporation, or trover or case to recover damages for its conversion or injury; but the right of action is in the corporation, and must be brought in the corporate name.⁵²

Rights of action accruing to a corporation belong to the corporation, and an action, whether in contract or in tort, and generally whether at law or in equity, cannot be maintained by the members

of its assets, and that his individual act in mortgaging them was good in the absence of prejudice to creditors.

51 2 Machen, Corporations, sec. 1077.

52 Button v. Hoffman, 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131; Smith v. Hurd, 12 Metc. (Mass.) 371, 46 Am. Dec. 690, 1706; Tomlinson v. Bricklayers' Union, 87 Ind. 308. See 5 Texas Law Rev. 77.

as individuals.⁵³ Such is the rule as to misconduct or fraud of directors and officers of a corporation by which its assets are misappropriated or reduced. Stockholders are not like partners, joint tenants or tenants in common, and cannot sue those who misapply corporate property while the corporation still exists. In equity, though not at law, a member of a corporation may maintain a representative suit to enforce rights of the corporation itself, if the corporation and its officers fraudulently refuse to enforce them.⁵⁴

Set-off by members.—In a suit against a corporation by a creditor of the corporation, demands due by the plaintiff to the stockholders as individuals cannot be interposed as equitable set-offs against the plaintiff's demand, even though the plaintiff is insolvent, and even though the stockholders interposing the set-off own all the stock in the corporation.⁵⁵ The very purpose of incorporation is to make the corporate enterprise a separate thing from the other business affairs of its members. The distinction between the rights of the corporation and its members must be strictly maintained, to keep corporate affairs free from complication and uncertainty. The reason for denying the set-off is that, in contemplation of law, the demands are not due from the plaintiff to the corporation, and the plaintiff's demand against the corporation is not a demand against the stockholders. A demand, to be the subject of a set-off, must be due from the plaintiff to the defendant.

It has been held, however, that where a corporation seeking to recover on a note was organized by one C for the transaction of his personal business, a note given by C to the defendant was a proper ground of counterclaim or set-off, where C was the real party in interest in the corporation, and he had confused his personal and his corporate affairs. The separation of corporate and personal affairs was disregarded.⁵⁶

⁵³ *Button v. Hoffman*, 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131; *Pratt v. Bacon*, 10 Pick. (Mass.) 123; *Smith v. Hurd*, 12 Metc. (Mass.) 371, 46 Am. Dec. 690; *Tomlinson v. Bricklayers' Union*, 87 Ind. 308; *Seitz v. Michel*, 148 Minn. 80, 181 N. W. 102, 12 A. L. R. 1060; *Brock v. Poor*, 216 N. Y. 387, 111 N. E. 229; *Boag v. Thompson*, 208 N. Y. App. Div. 132, 203 N. Y. Supp. 395.

⁵⁴ *Dodge v. Woolsey*, 18 How. (U. S.) 331, 15 L. Ed. 401. And see post, § 184 et seq.

⁵⁵ *Gallagher v. Germania Brewing Co.*, 53 Minn. 214, 54 N. W. 1115; *Erickson v. Revere Elev. Co.*, 110 Minn. 443, 126 N. W. 130; *Looney v. Thorpe Bros.*, 277 Fed. 367.

⁵⁶ *Western Securities Co. v. Spiro*, 62 Utah 623, 221 Pac. 856 (Corporate entity disregarded and set-off allowed); *United States Gypsum Co.*

Double taxation.—In taxation the legal separation may result in subjecting the same property or value to taxation to different persons. Shares are assessed to the stockholders as their property, and yet the capital, surplus and earning powers of the corporation are the measure of value of the shares. Although the states may not tax exempt bonds of the United States, yet they may tax the shares to their owners, the stockholders, without deducting the large amount of corporate funds invested in tax exempt securities which give value to the shares. The corporate assets belong to the corporation as a separate entity; the shares belong to the shareholders, and are a distinct, independent interest, subject to taxation.⁵⁷

Corporations controlled by the government.—Although a state or the United States cannot be sued without its consent, this doctrine does not prevent a suit against a corporation in which the state is a stockholder or has control. It has been held that the fact that the national government or a state is the sole proprietor of a corporation does not prevent the corporation from being sued, as being a mere agency or instrumentality of the government and sharing its immunity. Thus the Emergency Fleet Corporation was held liable to be sued upon its contracts and for its torts, notwithstanding the fact that it was a federal agency and that its stock was taken entirely by the United States. "The meaning of incorporation is that you have a person, and as a person one that presumably is subject to the general rules of law." It does not share the immunity of the sovereign from suit merely because it is an instrumentality of government. Other corporations, such as the Panama Railroad Company, all the stock of which was owned by

v. Mackey Wall Plaster Co., 60 Mont. 132, 199 Pac. 249. See 94 Cent. L. Journ. 96; 8 Minn. Law Rev. 442.

⁵⁷ *Des Moines Nat. Bank v. Fairweather*, 263 U. S. 103, 112, 68 L. Ed. 191, 44 Sup. Ct. 23; *United States Electric Power & Light Co. v. State*, 79 Md. 63, 28 Atl. 768; *People ex rel. Waclark Realty Co. v. Williams*, 198 N. Y. 54, 91 N. E. 266. See *A. A. Ballantine, Corporate Personality in Income Taxation*, 34 Harvard Law Review, 573, 582.

The U. S. Supreme Court usually looks to substance rather than to

form in taxation questions, but in case of reorganization it holds that the shares of stock issued by the new corporation are taxable as income to the old stockholder, although they represent the same investment and although there is the same business entity reorganized unless each stockholder has the same interest in the same property as before. See *Magill*, 24 Columbia Law Rev. 836, 847; *Marr v. United States*, 268 U. S. 536, 69 L. Ed. 1079, 45 Sup. Ct. 575; 12 Va. Law Rev. 319; 35 Harv. Law Rev. 363; 73 Uni. Pa. Law Rev. 83; 20 Ill. Law Rev. 601.

the United States have been similarly treated as separate entities.⁵⁸ And *a fortiori* a corporation is not exempt from suit merely because a state is a stockholder, or is otherwise partly interested therein. Where a state owning a canal transferred it to a corporation created by itself, and retained an interest therein, it was held that it thereby divested itself of its sovereignty as to the corporation, and that the corporation might be sued for mismanagement of the canal.⁵⁹

§ 6. Disregarding the corporate entity.—The separate corporate capacity is not disregarded when just limits are placed upon the exercise of the corporate privilege. If the corporate personality is used as a cover to evade statutes or obligations, the courts will impose liability upon the fraudulent parties. In some cases the corporation will be bound by acts of the individual stockholders, and in others stockholders will be personally liable for acts done in the name of the corporation. This sometimes occurs in the case of “one man companies” and parent and subsidiary corporations.

Limits on the corporate privilege.—The basic theory of corporation law is that a corporation exists as an entity entirely separate and apart from its stockholders. There is in many cases much loose talk about “ignoring the corporate fiction” and “looking at the substance rather than the form.” But the corporate capacity is a legal fact, not a fiction. Problems of responsibility for fraud or for the acts of a corporation or its stockholders are to be solved not by “disregarding” the corporate personality, but by a study of the just limitations upon the exercise of the legal privilege of separate capacity in view of its proper ends and functions.⁶⁰ A

⁵⁸ Panama R. Co. v. Curran, 256 Fed. 768; Sloan Shipyards Corp. v. United States Shipping Board Emergency Fleet Corp., 258 U. S. 549, 66 L. Ed. 762, 42 Sup. Ct. 386, 588. Contracts made by the Fleet Corporation for work on ships are enforceable against it though U. S. is sole stockholder. Although an instrumentality of the U. S., it was not immune from suit. United States v. Strang, 254 U. S. 491, 65 L. Ed. 368, 41 Sup. Ct. 165; Providence Engineering Corporation v. Downing Shipbuilding Corporation, 294 Fed. 641; Compare Ballaine v. Alaska Northern Ry. Co., 259 Fed.

183, 8 A. L. R. 990. See notes, 35 Harv. Law Rev. 335, 36 Harv. Law Rev. 218, 737; 8 Minn. Law Rev. 427.

⁵⁹ Moore v. Wabash & Canal, 7 Ind. 462; Commercial Pacific Cable Co. v. Philippine Nat. Bank, 263 Fed. 218 (effect of government ownership of stock in a bank).

⁶⁰ Canfield, Scope and Limits of Corporate Entity Theory, 17 Columbia Law Review, 128. A rigorous adherence to the entity theory or doctrine is essential in working out the problems for the ordinary operations of a corporation. See notes, 1 Am. L. Rep. 610, 34 A. L. B. 597; 4 Minn. L. Rev. 219, 227; 8 Minn.

corporation will be treated as a separate legal entity when used for the accomplishment of a legitimate business purpose. But corporations cannot be used as a cover under which fraud may be perpetrated or the rights of innocent parties defeated.⁶¹ In general the situations that call for a limitation of the separate entity of the corporation are when it is employed to defraud creditors, to evade an obligation of the incorporators, to circumvent a statute, to form a monopoly, to cover up fraud or crime or gain an unjust advantage or defense, or escape responsibility for acts done through subsidiary or auxiliary corporations. In some cases individual acts of stockholders will be binding upon the corporation, and in some cases corporate acts will not shield those behind the corporate screen from individual liability.⁶²

Fraudulent device.—If a corporation is organized as “a sham, a delusion, and a snare,” fraudulent in intent and execution, wholly without capital, and the business is carried on in such a way that the corporation will have no assets to meet its debts, it may well be held that the associates cannot set up such a “straw man” corporation to escape individual liability. Even though on the face of the incorporation papers there is a regular and com-

L. Rev. 442; 13 Calif. L. Rev. 235; 34 Harv. L. Rev. 584, 593; 10 Mich. Law Rev. 310; 17 Columbia Law. Rev. 137; 24 Columbia Law Rev. 798; 36 Yale Law Journal 254.

⁶¹ Brundred v. Rice, 49 Ohio St. 640, 32 N. E. 169, 34 Am. St. Rep. 589. See Macfadden v. Jenkins, 40 N. D. 422, 169 N. W. 151, 162.

If the separate corporate capacity is perverted to dishonest uses to evade obligations or to defeat public welfare, the courts will penetrate the device, uncover the abuse of the special privilege, and circumvent fraud. *United States v. Reading Co.*, 253 U. S. 26, 64 L. Ed. 760, 40 Sup. Ct. 425; *Linn & Lane Timber Co. v. United States*, 236 U. S. 574, 59 L. Ed. 725, 35 Sup. Ct. 440; *United States v. Lehigh Valley R. Co.*, 220 U. S. 257, 55 L. Ed. 458, 31 Sup. Ct. 387; *United States v. Milwaukee Refrigerator Transit Co.*, 142 Fed. 247 (dummy used to obtain rebates); *Rice v. Sanger Bros.*, 27 Ariz. 15, 229 Pac. 397; *Gardiner v. Treasurer & Receiver General*, 225 Mass. 355, 367, 114 N. E. 617. See *McWilliams, Limitations of the*

Theory of Corporate Entity in California, 4 California Law Review, 465; *Disregarding Corporate Entity in One Man Company*, 13 California Law Review, 496; Canfield, *Scope of Corporate Entity Theory*, 17 Columbia Law Review, 128; Wormser, *Piercing Veil of Corporate Entity*, 12 Columbia Law Review, 496; Ballantine, *Separate Entity of Parent & Subsidiary Corporations*, 14 California Law Review, 12.

⁶² In some cases a corporation may be affected by notice to or acts of its stockholders. A stockholder may be disqualified to act as judge when the corporation is a party. The separation of capacities cannot be unqualified. An executor who fails to sue a corporation of which he is sole stockholder cannot take indirect advantage of his breach of duty and set up the statute of limitations, the corporate debt being in substance his own. It would be an abuse of the privilege of separate capacity. *Minifie v. Rowley*, 187 Cal. 481, 202 Pac. 673.

plete compliance with the incorporation statute, the fraudulent use of the corporate entity may be ineffectual to exempt the dishonest associates from personal liability.⁶³ As the separate personality or capacity of a corporation is a statutory privilege, it must be used for legitimate business purposes and must not be perverted into a fraudulent device. It may not be utilized as a cloak or disguise to evade contracts or obligations. If A agrees not to compete with B to protect B in the purchase of the good will of his business, and then organizes a corporation for the dishonest purpose of conducting the same business under the corporate name, the separate personality of the corporation will not shield it from liability for the breach of A's contract.⁶⁴ In a federal case one Smith, discovering that his patents to government land were void, formed a corporation and deeded his land to it, but did not record the deed until after action had been commenced by the United States to annul the patents on the ground of fraud. The corporation was not brought into the suit until more than 6 years after the issue of the patents. Smith held 998 shares out of 1,000; his wife one; his attorney one. It was held that the purpose being to busy the United States with the wrong person until the statute of limitations had run, the trick must fail.⁶⁵ When the real purpose for which a corporation is formed is to use it as an instrumentality in the ob-

⁶³ *Christian & Craft Grocery Co. v. Fruitdale Lumber Co.*, 121 Ala. 340, 25 So. 566; *Rice v. Sanger Bros.*, 27 Ariz. 15, 229 Pac. 397. But compare *Moe v. Harris*, 142 Minn. 442, 172 N. W. 494, where the anomaly was allowed of a corporation without stockholders or capital stock, a fictitious entity indeed without body, soul or pocketbook. See 7 Minn. Law Review, 80; *Hildebrand*, 1 Tex. Law Rev. 52; *Wormser*, 12 Columbia Law Rev. 517.

⁶⁴ *Beal v. Chase*, 31 Mich. 490; *Norma Min. Co. v. Mackay*, 241 Fed. 640; *Higgins v. California Petroleum Co.*, 147 Cal. 363, 81 Pac. 1070; *Donovan v. Purtell*, 216 Ill. 629, 75 N. E. 334, 1 L. R. A. (N. S.) 176; *Gardiner v. Treasurer and Receiver General*, 225 Mass. 355, 114 N. E. 617; *Kramer v. Old*, 119 N. C. 1, 25 S. E. 813, 34 L. R. A. 813, 56 Am. St. Rep. 650.

It has been held that a covenant that title to certain land should

never vest in colored persons was not violated by a conveyance to a corporation composed exclusively of negroes formed to establish a pleasure park for the amusement of colored persons. It may be doubted whether this was not a wrongful evasion, a use of the privilege of separate entity to evade an obligation and perpetrate a fraud. *People's Pleasure Park Co. v. Rohleder*, 109 Va. 439, 61 S. E. 794, 63 S. E. 981.

⁶⁵ *Linn & Lane Timber Co. v. United States*, 236 U. S. 574, 59 L. Ed. 725, 35 Sup. Ct. 440 (corporation a mere tool); *Rickey Land & Cattle Co. v. Miller & Lux Co.*, 218 U. S. 258, 263, 54 L. Ed. 1032, 31 Sup. Ct. 11. The corporation was merely Rickey under another name, a device to dodge jurisdiction. See *Higgins v. California Petroleum Co.*, 147 Cal. 363, 81 Pac. 1070.

taining of rebates under the disguise of commissions, the fact of incorporation will not avail the promoters or members as a defense.⁶⁶

One situation in which courts sometimes speak of disregarding separate entity is that of the transfer by a corporation which is in debt of all its assets and business to another corporation having often a similar name and substantially the same stockholders and management. The real basis on which the creditors of the old can pursue the new corporation to the extent of the assets received is not because it is the same corporation under a different name, but on the principles of fraudulent conveyance, perhaps made somewhat more favorable to the creditor than if the transferee were an individual.⁶⁷ It would seem that the creditors may proceed against the transferee without disregarding the corporate entity or identifying the grantee and the grantor, the corporation and its stockholders. The figurative talk about "piercing the veil" or "stripping off the mask" of a separate corporate entity does not help and the real questions involved are often thus obscured.

Individual acts binding the corporation.—In many cases of "one man" corporations, where the courts say that they "disregard the fiction" of separate corporate personality, they might better reach the desired result by holding the corporation bound without the usual formalities. The acts of the sole stockholder in dealing with the corporate property will affect the corporation, although not done in the corporate name, or by authority of the board of directors, since he is the only person beneficially interested. If he does not distinguish between corporate business and his individual affairs, there is no reason why the courts should

⁶⁶ *United States v. Milwaukee Refrigerator Transit Co.*, 142 Fed. 247. In this case the U. S. sought an injunction to prevent the payment of rebates on freight to shippers in violation of the Elkins Act of 1903. The Pabst Brewing Co. had caused a transit company to be formed as a subsidiary. By contract the brewing company gave the transit company exclusive control of the shipping of its freight over the railroads. The transit company received commissions from the railroads for procuring the business for the railroads. The separate corporate entity was here used in an at-

tempt to evade the law and cover up the crime of rebating.

⁶⁷ *Blanc v. Paymaster Min. Co.*, 95 Cal. 524, 30 Pac. 765, 29 Am. St. Rep. 149; *Rock v. Speedwell Motor Car Co.*, 24 Cal. App. 123; *Strahm v. Fraser*, 32 Cal. App. 447; *Montgomery Web Co. v. Dienelt*, 133 Pa. St. 585, 19 Atl. 428; *Matchan v. Phoenix Land Inv. Co.*, 159 Minn. 132, 198 N. W. 417. See *Stanford Hotel Co. v. Schwing*, 180 Cal. 348, 181 Pac. 780 (transferee corporation having same stockholders is liable for debts of transferor and subject to attachment). 8 Calif. Law Rev. 436.

insist on corporate formalities.⁶⁸ Where it appears that a corporation is but the instrumentality through which an individual who is the sole owner of all of the capital stock transacts his business, both law and equity will hold the corporation obligated by the acts of the sole owner. The corporation cannot escape liability by the plea that the contract or transfer was made without observance of the formal requisites of the making of contracts, such as a resolution of the directors. The contract of the sole owner of the stock will be regarded as binding the corporation if so intended.⁶⁹

In the same way a corporation may be affected by the contract or act of all the stockholders when they enter into transactions intended to affect its legal relations or business as if there had been formal corporate action by the authorized officers. Thus in a leading Ohio case, *quo warranto* proceedings were brought against the Standard Oil Company to oust it of the right to be a corporation, on the ground that it had abused its corporate franchises by becoming a party to a trust agreement, which was against public policy. The proceedings were resisted on the ground that the agreement was made by the individual stockholders of the corporation in their individual capacity, and was not the agreement of the corporation. The defense was based upon the argument that the corporation was a legal entity, separate from its stockholders; that in it were vested all the property and powers of the company, and that it could only be affected by such acts and agreements as might be done or executed on its behalf by its corporate agencies, acting within the legitimate scope of their powers; that its stockholders were not the corporation; that their shares were their individual property, and that they might each and all dispose of and make such agreements affecting their shares as might best suit their

⁶⁸ On effect of one person holding the stock upon the corporate entity, see *Macan v. Scandnavia Belting Co.*, 264 Pa. 384, 107 Atl. 750, 5 A. L. R. 1502; *Looney v. Thorpe Bros.*, 277 Fed. 367, 371; *Salvin v. Myles Realty Co.*, 227 N. Y. 51, 124 N. E. 94, 6 A. L. R. 581; *In re Wilson's Estate*, 85 Ore. 604, 167 Pac. 580; *Eichelberger v. Arlington Bldg., Inc.*, 280 Fed. 997; *Erkenbrecher v. Grant*, 187 Cal. 7, 200 Pac. 641; *Star Brewing Co. v. Flynn*, 237 Mass. 213, 129 N. E. 438.

⁶⁹ Informal action by all the stockholders may bind the corporation. *Kentucky Coal Lands Co. v. Mineral*

Development Co., 295 Fed. 255; *Suduth v. Storm King Coal Co.*, 268 Fed. 433; *G. V. B. Min. Co. v. First Nat. Bank*, 95 Fed. 23; *Harrison v. Repetti*, 160 N. Y. Supp. 1018; 15 Mich. Law Rev. 264; *Wenban Estate, Inc. v. Hewlett*, 193 Cal. 675, 227 Pac. 723; *Campbell v. Hanford*, 67 Cal. 155, 227 Pac. 234; 24 Columbia Law Review, 798; See *Buffalo Loan, Trust & Safe Deposit Co. v. Medina Gas & Electric Light Co.*, 162 N. Y. 67, 56 N. E. 505, aff'd 12 App. Div. 199, 42 N. Y. Supp. 781; *Compare Palmer v. Ring*, 113 N. Y. App. Div. 643, 99 N. Y. Supp. 290.

private interests; and that no such acts and agreements of the stockholders could be ascribed to the company as a separate entity, though done and concurred in by each and all of its stockholders. The court, however, held the corporation on the following issue: "Whether the act in question, though done by shareholders, that is to say, by the persons united in one body, was done simply as individuals, and with respect to their individual interests as shareholders, or was done ostensibly as such, but, as a matter of fact, to control the corporation and affect the transaction of its business, in the same manner as if the act had been clothed with all the formalities of a corporate act."⁷⁰

If the sole stockholder of a corporation sets fire to its property in order to get the insurance, his act would be a defense to an action for the insurance. He could not be allowed to profit in his corporate capacity by a fraudulent act done in his individual capacity. The law does not suffer itself to be circumvented by specious devices or disguises.⁷¹

Individual liability for corporate acts.—Before the acts and obligations of a corporation can be legally recognized as those of particular individuals, and vice versa, it must appear that the circumstances are such that there is an agency of the one for the other or that the privilege is being abused so that an adherence to the distinction or separate capacity would sanction a fraud or promote injustice.⁷² It is legitimate to incorporate for the purpose

⁷⁰ *State v. Standard Oil Co.*, 49 Ohio St. 137, 30 N. E. 279, 34 Am. St. Rep. 541, 15 L. B. A. 145. There was a similar decision in New York in a suit to forfeit the charter of the North River Sugar Refining Company because of its entering into an agreement and combination for the purpose of forming a trust. The combination having been effected by a transfer of their stock and a trust agreement on the part of all the stockholders and trustees, it was contended that everything that was done was done by the stockholders, and not by the corporation, or, as it was put by Judge Finch, "that while all that was human and could act had sinned, yet the impalpable entity had not acted at all and must go free." This contention, however, was not sustained, and there was a judgment of dissolution. *People v. North River Sugar Refining Co.*, 121

N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843. See *I. M. Wormser*, 12 Columbia Law Rev. 509-513.

⁷¹ *Meily Co. v. London & Lancashire Fire Ins. Co.*, 148 Fed. 683; *Kirkpatrick v. Allemannia Fire Ins. Co.*, 102 N. Y. App. Div. 327, 92 N. Y. Supp. 466; *D. I. Felsenthal Co. v. Northern Assur. Co., Ltd.*, 284 Ill. 343, 120 N. E. 268, 1 A. L. R. 602, *Disregarding corporate existence. Fire set by creditor of corporation to whom stock had been pledged. Corporation cannot recover on fire insurance policy, because incendiary-creditor would receive all the proceeds.*

⁷² *Donovan v. Purtell*, 216 Ill. 629, 75 N. E. 234, 1 L. R. A. (N. S.) 176; See 17 Col. Law Rev. 140; 12 Col. L. Rev. 506. A real estate operator got up a number of realty companies, all of which had offices

of escaping personal liability in contract or in tort if no fraud is intended.

In a New York case an individual was sued for personal injuries suffered by plaintiff by a fall on a defective stairway in a building operated by a corporation. It was contended that the corporation held the title to the real estate as a subterfuge to relieve the stockholder, the real owner, from liability. The capital stock was \$1000, consisting of 100 shares of a par value of \$10 each, held by S and the members of his family. It was held that the fact that S owned all but a few shares and was the dominating and controlling factor and only active manager did not destroy the separate corporate existence in the eyes of the law. Even if the corporation was the creature of S organized for the very purpose of escaping personal liability, that did not make S liable, since that is a lawful use of the corporate privilege.⁷³

One man company.—There is no more justification for saying that a corporation is the agent of its sole shareholder than for saying that it is agent for several shareholders acting together. The corporation may become their agent if the facts show agency. But control through stock ownership does not expose stockholders to liability for acts of the corporation. The relation is that of shareholders and this does not constitute the company their agent to bind them personally.

In *Broderip v. Salomon*,⁷⁴ Aron Salomon, a solvent bootmaker turned over his business to a limited company. The subscribers to the memorandum were Salomon, his wife and 5 children. The business was transferred to A. Salomon & Company, Ltd. Salomon received £1000 in cash; £10,000 in debentures and half the authorized capital stock in fully paid up shares. Only seven other shares were issued to the subscribers. Broderip loaned £5000 on de-

in the same room, the main purpose being to evade judgments. Donovan used the corporate entity for the transaction of his private business, and not as a separate or independent enterprise, using the property of the companies indiscriminately. It was held that the plaintiff who had entrusted money to Donovan and received an obligation of one of these companies, could hold him personally liable to return the amount so received by him under the corporate name.

⁷³ *Elenkrieg v. Siebrecht*, 238 N. Y. 254, 144 N. E. 519, 34 A. L. R. 592.

⁷⁴ L. R. [1895] 2 Ch. 323; 1897 A. C. 22. See also *Gramophone, etc., Ltd. v. Stanley*, [1906] 2 K. B. 856; [1908] 2 K. B. 89. The acquisition of the whole of the shares of a corporation by one individual does not of itself alter his relationship to the corporation or make him and the corporation in any sense identical. The directors do not become his agents.

ventures. In liquidation the rights of Salomon as a creditor of the corporation were attacked, as the unsecured creditors were likely to get nothing. The lower court considered that A. S. & Co., Ltd. was so identical with Aron Salomon that creditors could have sued him personally. The Court of Appeal held that corporation was a kind of trustee created for an illegal purpose, to pervert the corporate form to defraud creditors. The House of Lords held however, that although it was intended to be a one man company and the stockholders other than Salomon were dummies, that nevertheless the corporation was a different person from its sole real shareholder. After incorporation the business was the same as before, the same persons were managers, and the same owner received the profits. But limited liability is a legitimate object, and the company was not the agent of the stockholders or trustee for them. Salomon as a debenture holder could prove his claim against the assets of his own business in preference to the general creditors.

Suppose that the sole stockholder of a corporation, after purchase of all the stock, does business openly in his own name as an individual and uses the corporate property in his business; would the corporate assets be liable for his personal debts, or only the stock? The property of the corporation cannot normally be attached to recover a debt of the sole shareholder or vice versa. The remedy of the individual creditor is to attach the shares owned by the defendant debtor. This protects creditors of the corporation. But the affairs of the corporation and the individual may become so confused and intermingled that the separate corporate entity cannot be regarded as to title to property or liability for debts. In a Kentucky case it was said that the defendant had literally "swallowed the corporation whole," and had thereby come under a duty to pay its debts.⁷⁵

Parent and subsidiary corporations.—An important question in corporation law is the effect of the connection between a parent corporation and its subordinate branches, or subsidiaries. When will they be found joined in a union so close as to amount to practical identification, so that the formal separation of legal entities

⁷⁵ One man company; sole stockholder's liability for corporate debts; disregarding entity. *Louisville & N. R. Co. v. Nield*, 186 Ky. 17, 216 S. W. 62, 29 Yale L. J. 659, 664. See *Quaid v. Ratkowsky*, 183 N. Y. App. Div. 428, 170 N. Y. S. 812; *Segal v.*

Davis, 166 Minn. 265, 207 N. W. 620. Proceedings may be direct against the sole stockholder of a defunct corporation or officers of a corporation who have absorbed its assets leaving creditors in the lurch.

will be disregarded? What system of control exercised by a corporation over its subsidiaries will involve responsibility for their torts and contracts?

In numerous cases it is contended that a subsidiary corporation is so far owned and controlled by another as to make the parent corporation responsible for the acts and obligations of the subsidiary. Unfortunately it does not seem to be possible to lay down any definite test as to when the usual immunity of the stockholder should be disregarded, but the courts assign various grounds which to a great extent are vague and illusory. It may be found in the first place that in substance the relation of principal and agent exists between the two corporations. It is often said, secondly, that one corporation is the mere "agency," "adjunct," or "instrumentality" of the other, as if this were something different from principal and agent. In other cases the courts speak of the two corporations as being the same identical concern under different names by reason of the mingling or confusing of their business affairs, as where one is merely the selling agency of the other. In other cases the courts purport to go only on the ground of prevention of fraud, evasion and illegality.⁷⁶ In numerous cases the holding company has been held liable for the contracts and debts of its subsidiary.⁷⁷ In other cases the holding company is held not liable unless the relation of principal and agent exists.⁷⁸ In many cases

⁷⁶ Chicago, M. & St. P. R. Co. v. Minneapolis Civic & Commerce Ass'n, 247 U. S. 490, 62 L. Ed. 1229, 38 Sup. Ct. 553; Cannon Mfg. Co. v. Cudahy Packing Co., 267 U. S. 333, 69 L. Ed. 634, 45 Sup. Ct. 250; 13 Calif. Law Rev. 235; Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 Calif. Law Review, 12. In re Marcella Cotton Mills, 8 Fed. (2d) 522; Ehlers v. Bankers' Fire Ins. Co., 108 Neb. 756, 189 N. W. 159.

⁷⁷ In the following cases the holding company was held liable for the debts of its subsidiary: Fourth Nat. Bank of Montgomery v. Portsmouth Cotton Oil Refining Corp., 280 Fed. 879, 284 Fed. 718; Luckenbach S. S. Co. v. W. R. Grace & Co., 267 Fed. 676, 681 (complete dominance, puppet, business intermingled); Stark Elec. R. Co. v. McGinty Contracting Co., 238 Fed. 657; United States v. United Shoe Machinery Co., 234 Fed. 127 (subsidiary merely selling

or leasing department of parent corporation which is liable for its acts) noted in 15 Michigan Law Review, 78. Compare Interstate Tel. Co. v. Baltimore & O. Tel. Co., 51 Fed. 49, 54 Fed. 50; Dillard & Coffin Co. v. Richmond Cotton Oil Co., 140 Tenn. 290, 204 S. W. 758 (parent liable for debts of dummy, complete control); Platt v. Bradner, 131 Wash. 573, 230 Pac. 633 (mere agency of owning company); see Kelly v. Ning Yung Benev. Ass'n, 2 Cal. App. 460, 84 Pac. 321 (services rendered at instance of officer of parent corporation). Seymour v. Woodstock & S. Traction Co., 281 Ill. 84, 117 N. E. 729. (Construction company dominated and controlled by railroad company is mere agent of railroad company.)

⁷⁸ In the following cases the holding company was held not liable for the debts of the subsidiary. City of Holland v. Holland City Gas Co., 257 Fed. 679; New York Trust Co.

a parent corporation has been held liable for the negligence and other torts of the subsidiary.⁷⁹ In other cases the parent corporation is held not liable.⁸⁰ In certain cases the assets of the subsidiary are held to be assets of the bankrupt parent corporation and creditors of the parent may enforce their claims against them.⁸¹

The question is sometimes raised whether the parent corporation can prove its claims against the insolvent subsidiary in competition with its creditors. A few cases have gone so far as to hold that where the parent corporation has conducted its business through the instrumentality of the subsidiary that capital advanced may not be treated as a loan to the subsidiary as against third parties. The controlling corporation, it has been contended, cannot share as a creditor in the assets of the insolvent subsidiary, on the theory that the parent which invests money in a branch of its own business

v. Carpenter, 250 Fed. 668; Martin v. Development Co. of America, 240 Fed. 42; Pittsburgh & Buffalo Co. v. Duncan, 232 Fed. 584; Richmond & L. Const. Co. v. Richmond N., I. & B. R. Co., 68 Fed. 105, 34 L. R. A. 625; Marsch v. Southern New England R. Corp., 230 Mass. 483, 120 N. E. 120; Borough of Ambridge v. Philadelphia Co., 283 Pa. 5, 129 Atl. 67.

⁷⁹ Parent corporation liable for torts. Davis v. Alexander, 269 U. S. 114, 46 Sup. Ct. 34, "Where one railroad company actually controls another and operates both as a single system, the dominant company will be liable for injuries due to the negligence of the subsidiary." Gulf C. & S. F. Ry. Co. v. Cities Service Co., 281 Fed. 214; The Willem Van Driel S., 252 Fed. 35; Joseph R. Foard Co. v. State of Maryland, 219 Fed. 827 (business not kept separate; funds of subsidiary dealt with as if they were parent's); State of Maryland v. General Stevedoring Co., 213 Fed. 51; Westinghouse Elec. & Mfg. Co. v. Allis Chalmers Co., 176 Fed. 362; Lehigh Valley R. Co. v. Du Pont, 128 Fed. 840; Lehigh Valley R. Co. v. Delachesa, 145 Fed. 617; Finnish Temperance Society v. Finnish Socialistic Pub. Co., 238 Mass. 345, 130 N. E. 845. Cf. Marsch v. Southern New England R. Co., 230 Mass. 483, 120 N. E. 120; Erickson v. Minnesota & O. Power Co., 134 Minn. 209,

158 N. W. 979; Specht v. Missouri Pac. R. Co., 154 Minn. 314, 191 N. W. 905 (principal and agent); Auglaize Box Board Co. v. Hinton, 100 Ohio St. 505, 126 N. E. 881, 885; Oriental Inv. Co. v. Barclay, 25 Tex. Civ. App. 543, 64 S. W. 80 (principal and agent).

⁸⁰ In the following cases the parent corporation was held not liable for the negligence or tort of the subsidiary. Union Sulphur Co. v. Freeport Texas Co., 251 Fed. 634, 661; Atchison, T. & S. F. R. Co. v. Cochran, 43 Kans. 225, 23 Pac. 151, 7 L. R. A. 414, 19 Am. St. Rep. 129; Stone v. Cleveland, C. C. & St. L. Ry. Co., 202 N. Y. 352, 95 N. E. 816, 35 L. R. A. (N. S.) 770; Berkey v. Third Avenue Ry. Co., 244 N. Y. 84, 155 N. E. 58. See Bethlehem Steel Co. v. Raymond Concrete Pile Co., 141 Md. 67, 118 Atl. 279.

⁸¹ In re Eilers Music House, 270 Fed. 915, 274 Fed. 330; In re Rieger, Kapner & Altmann, 157 Fed. 609; In re Muncie Pulp Co., 139 Fed. 546, (subsidiary used as a mere agent or creature of the bankrupt with no independent or separate business existence); Baltimore & O. Tel. Co. v. Interstate Tel. Co., 54 Fed. 50, (judgment creditor of parent reaches funds realized from sale of plant of subsidiary); Day v. Postal Tel. Co., 66 Md. 354, 7 Atl. 608 (dominant corporation managed subsidiary without regard to interests of its shareholders).

cannot in case of failure shift the loss to innocent parties, or enforce a claim against itself.⁸²

It has been asserted that where stock ownership is resorted to not for the purpose of participating in the affairs of the corporation in the customary and usual manner, but for the purpose of controlling the subsidiary company so that it may be used as a mere adjunct, agency or instrumentality of the owning company, the court will not permit itself to be blinded by mere corporate form, but will in a proper case disregard the corporate entity and treat the two corporations as one, or at least as responsible for each other.⁸³

What is meant by such terms as "adjunct," "agency," "instrumentality," "creature" or "mouthpiece"? What conditions must exist to warrant a court in treating the A corporation as the mere adjunct of the B corporation? The word "agency" is often used as a synonym of "adjunct," whatever that may mean, and as descriptive of a relation variously defined in the cases as "alter ego," "alias," "device," "dummy," "branch," "tool," "corporate double," "business conduit," "instrumentality," etc., but all in the sense of "means" through which a corporation's own business is actively prosecuted. It clearly appears that the word "adjunct" and these other terms like "business conduit," are too uncertain to be adopted as a test or rule of law to indicate when adherence to the doctrine of separate and distinct corporate entity will work injustice or amount to a perversion of corporate capacity.⁸⁴

One corporation may be the agent of another, just as one individual may act for another. The difficult question is what facts of ownership, control, and management in a common enterprise should require that the acts and obligations and property of the subsidiary

⁸² *Hunter v. Baker Motor Vehicle Co.*, 225 Fed. 1006, 1015; *Clere Clothing Co. v. Union Trust & Sav. Bank*, 224 Fed. 363; *S. G. V. Co. of Delaware v. S. G. V. Co. of Pennsylvania*, 264 Pa. St. 265, 107 Atl. 721; but see contra, *Peckett v. Wood*, 234 Fed. 833; *In re Watertown Paper Co.*, 169 Fed. 252 (separate corporate organization and books maintained); see 15 *Michigan Law Review*, 172.

⁸³ *Chicago, M. & St. P. R. Co. v. Minneapolis Civic & Commerce Ass'n*, 247 U. S. 490, 62 L. Ed. 1229, 38 Sup. Ct. 553; *Radio-Craft Co. v.*

Westinghouse Elec. & Mfg. Co., 7 Fed. (2d) 432; *Hunter v. Baker Motor Vehicle Co.*, 225 Fed. 1006; *Advance-Rumley Thresher Co. v. Geyer*, 40 N. D. 18, 168 N. W. 731; *Platt v. Bradner Co.*, 131 Wash. 573, 230 Pac. 633, 634; 1 *Fletcher, Cyc. of Corporations*, p. 63, § 45; 10 *Fletcher, Cyc. of Corporations*, p. 11, § 45; see *Wenban Estate, Inc. v. Hewlett*, 193 Cal. 675, 227 Pac. 723; 12 *Columbia Law Review*, 502, 503.

⁸⁴ *New York Trust Co. v. Carpenter*, 250 Fed. 668; 32 *Harvard Law Review*, 424; but see *Wormser*, 12 *Columbia Law Review*, 503, 504.

should be treated as if they were those of the parent.⁸⁵ It is submitted that no mechanical rule based on objective facts of control or connection which will furnish a certain test is possible of formulation. Identity of stockholders, identity of officers, the manner of keeping books and records, the methods of conducting the corporate business as a separate concern or as a mere department of the other concern, may be evidential facts to be considered as bearing on the question of juggling of separate capacities and whether the subsidiary is being managed in such a way as to make the controlling corporation justly responsible.⁸⁶ But after all it comes down to a question of good faith and honesty in the use of the corporate privilege for legitimate ends. If a corporation is owned and controlled by another and is manipulated by the owner for its own purposes and in its own interests to the prejudice of innocent third parties, or the public welfare, it may be necessary to limit such abuse of the corporate capacity or shield. But in the ordinary case the fact that the shares of one company all belong to another does not make the subsidiary a mere alias, or trustee or agent for the parent company or for the shareholders of the parent company.

Enemy character.—Enemy character or status may affect a corporation during war (1) by disabling it from suing in the domestic courts; (2) making it a criminal offense of trading with the enemy to have commercial intercourse with it; (3) causing the abrogation of executory pre-war contracts with the corporation; (4) stamping with enemy character the property of such corporation and making it subject to seizure. During the world war the question arose whether the friendly character of a domestic corporation changed because on the outbreak of war all the shareholders and directors resided in an enemy country and therefore became alien enemies. In the famous *Daimler Co.* case,⁸⁷ the Continental

⁸⁵ See *Erickson v. Minnesota & O. Power Co.*, 134 Minn. 209, 158 N. W. 979; *Advance-Rumley Thresher Co. v. Geyer*, 40 N. D. 18, 163 N. W. 731, n. 16.

⁸⁶ *Berkey v. Third Avenue Ry. Co.*, 244 N. Y. 84, 155 N. E. 58, 61. See notes in 4 *Minnesota Law Review*, 219; 29 *Yale Law Journal*, 663.

Under the commodities clause, a railroad may not use stock ownership of a subsidiary for the purpose of commingling its affairs with those of the railroad so as to make the

two corporations virtually one, and do by indirection what the commodities clause prohibits. *United States v. Lehigh Val. R. Co.*, 220 U. S. 257, 55 L. Ed. 458, 31 Sup. Ct. 387; s. c., 251 U. S. 255, 65 L. Ed. 253, 41 Sup. Ct. 104; *United States v. Reading Co.*, 253 U. S. 26, 64 L. Ed. 760, 40 Sup. Ct. 425.

⁸⁷ On disregarding the corporate entity where the stock is owned by alien enemies in time of war, see *Continental Tyre Co. v. Daimler*, [1915] 1 K. B. 833; [1916] 2 A. C.

Tyre Co., the plaintiff, was an English company carrying on business in England. All the stock except one share was held by German subjects residing in Germany and all its directors were also Germans. The defendant, the Daimler Company was indebted for goods supplied it before the war, but contended that the plaintiff company, being an alien enemy, could not sue in England to collect the debt. The Court of Appeal gave judgment for the plaintiff company. The House of Lords reversed the decision on the formal ground that the secretary after the outbreak of war could not legally acquire authority to sue. Various opinions were expressed *obiter* as to when the separate corporate entity would be disregarded on the ground that the stockholders and officers in control of its affairs are resident in an enemy country, so that enemy control rather than the country of incorporation must be looked to. The statutes of the United States during the world war were not so drawn as to authorize seizure of corporate property merely because of enemy stockholders having the controlling interest.⁸⁸ Serious difficulties and confusion would follow the effort to fix the status of corporations as enemy or not according to the nationality or residence of stockholders.⁸⁹ Corporations of neutral countries, although controlled by enemy stockholders were never declared to be "enemy" unless they did business within hostile territory or were incorporated therein.

307, Ann. Cas. 1917 C 170; 38 Law Quart. Rev. 13.

In *Re Bayer* [1921] 2 Ch. 331, 367, it was pointed out that it would be a paradoxical result if the King's enemies who constitute the entire body of corporators in a company registered in England thereby pass out of the range of legal vision, and instead a corporation, which in itself is incapable of loyalty or enemy or residence or anything but bare existence in contemplation of law and registration under some system of law, takes their place for the most important of all purposes, that of being classed among the king's friends or among his foes in time of war.

⁸⁸ *Swiss Nat. Ins. Co. v. Miller*, 267 U. S. 42, 69 L. Ed. 504, 45 Sup. Ct. 213. "Under the act a corporation is an entity with a character of its own irrespective of the status attributed to its stockholders, and is "enemy" only when

directly within the statutory definition." *Behn, Meyer & Co. v. Miller*, 266 U. S. 457, 69 L. Ed. 374, 45 Sup. Ct. 165. A British corporation which had never done business in enemy territory did not come within the definition although German nationals owned the controlling interest. See 24 *Columbia Law Rev.* 602. Test of enemy character, 14 *California Law Review*, 497.

⁸⁹ As to the tests for determining the friendly or hostile character of a corporation organized under domestic or neutral governments as affected by the holding of stock or control by alien enemies, see *Continental Tyre Co. v. Daimler* [1915] 1 K. B. 833, rev. [1916] 2 S. C. 307; In *re Bayer*, [1921] 2 Ch. 331, 367; 29 *Yale Law Journal*, 772; 27 *Yale L. J.* 169, 175; 32 *Law Quart. Rev.* 340; 38 *Law Quart. Rev.* 13; 30 *Harv. Law Rev.* 83; *British Year Book of International Law*, 1923-24, p. 44.

§ 7. Citizenship and domicile of a corporation.—For some purposes, a corporation may be regarded as a citizen, resident, or inhabitant of the country or state under whose laws it was created; and it can make no difference that some or even all of its stockholders or members are citizens or residents of some other country or state, or that it is doing business through its agents in some other country or state.

As a rule, the domicile of a corporation within a state is at the place where it has its principal office or place of business.

The settled doctrine is that a corporation, for jurisdictional purposes, is a citizen, resident, or inhabitant of the country or state by or under whose laws it was created or organized; and that it can make no difference whatever, in the application of this doctrine, that the members or stockholders of the corporation are citizens and residents of some other country or state, or that the corporation is engaged in business in some other country or state with its express or implied consent.

The constitution of the United States and acts of congress in pursuance thereof give the federal courts jurisdiction of actions between citizens of different states. In construing the constitution and these acts of congress, and applying them to actions by or against corporations, the supreme court of the United States has held, *in effect*, that a corporation is to be regarded as a citizen of the state by or under whose laws it is created, and that no averment or proof of the citizenship of its members elsewhere will be permitted. And the principle applies in any other case in which it is necessary to determine the citizenship of a corporation.⁹⁰ On the

⁹⁰ *Baltimore & O. R. Co. v. Harris*, 12 Wall. (U. S.) 65, 20 L. Ed. 354; *Muller v. Dows*, 94 U. S. 444, 24 L. Ed. 207; *Barron v. Burnside*, 121 U. S. 186, 30 L. Ed. 915, 7 Sup. Ct. 931; *Shaw v. Quincy Min. Co.*, 145 U. S. 444, 36 L. Ed. 768, 12 Sup. Ct. 935; *St. Louis & S. F. Ry. Co. v. James*, 161 U. S. 545, 40 L. Ed. 802, 16 Sup. Ct. 621; *Louisville, N. A. & C. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552, 43 L. Ed. 1081, 19 Sup. Ct. 817; *Doctor v. Harrington*, 196 U. S. 579, 49 L. Ed. 606, 25 Sup. Ct. 355; *Charles Friend & Co. v. Goldsmith & Seidel Co.*, 307 Ill. 45, 138 N. E. 185; *Garman v. A. B. Leach & Co.*, 11 Fed. (2d) 454.

It has been said that a corporation cannot be a citizen of any state,

but that, for the purposes of federal jurisdiction, all the members of a corporation are conclusively presumed to be citizens of the state to whose laws it owes its existence. *Muller v. Dows*, 94 U. S. 444, 24 L. Ed. 207; *Bank of United States v. Deveaux*, 5 Cranch (U. S.) 61, 3 L. Ed. 38; *Marshall v. Baltimore & O. R. Co.*, 16 How. (U. S.) 314, 14 L. Ed. 953; *St. Louis & S. F. Ry. Co. v. James*, 161 U. S. 545, 40 L. Ed. 802, 16 Sup. Ct. 621. But there is clearly no reason or necessity for this splitting of hairs. As we have seen, an action by or against a corporation is not in any sense an action by or against its members, but is an action by or against the corporation as an artificial person

same principle, a corporation is a resident or inhabitant of the country or state by or under whose laws it was created, and of that country or state only, although it may be engaged in business and have an office in another country or state.⁹¹ If a corporation is organized in another state for the very purpose of having matters in litigation determined in the federal courts on grounds of diversity of citizenship this is regarded as a sham and an abuse, and federal jurisdiction will be refused.⁹²

Corporations under the laws of different states.—Corporations like railroad companies, bridge companies, and the like, created by or under the laws of different states, may have the same name and the same powers, and be under the management of the same directors and officers, so as to be regarded in popular understanding, as if they were one corporation. In the law, however, they are not one corporation, but several and distinct corporations, and each is a citizen and resident or inhabitant of the state by or under whose laws it was created. Where one state creates a corporation for the purpose of conducting operations within its limits, and also within the limits of an adjoining state, the other state may also create a corporation with the same members or stockholders, the same name and powers, and the same management; but since a corporation is purely a creature of the law, and since the laws of a state can have no extraterritorial operation, two states cannot *jointly* create a single corporation. In each state there is a corporation which is a citizen of that state.⁹³ This principle also applies when the legis-

having a legal entity entirely separate and distinct from its members. And there is no reason why it cannot properly be said that a corporation itself is a "citizen," not in the strict sense of the term, but within the meaning of statutes defining the jurisdiction of courts. See 41 Am. Law Review, 38; 6 Wis. Bar Ass'n Rep. 227; 1 Va. Law Rev. 507; 56 Am. Law Review, 85; 55 Id. 85.

⁹¹ Shaw v. Quincy Min. Co., 145 U. S. 444, 36 L. Ed. 768, 12 Sup. Ct. 935. See *In re Bayer*, [1921] 2 Ch. 331, 366 on the effect of foreign control of domestic corporation to give it an enemy status in time of war; ante, § 6.

⁹² Miller & Lux v. East Side Canal & Irrigation Co., 211 U. S. 293, 53 L. Ed. 189, 29 Sup. Ct. 111; Southern Realty Inv. Co. v. Walker, 211

U. S. 603, 29 Sup. Ct. 211, 53 L. Ed. 346.

⁹³ It was said in a late case in the circuit court of appeals: "It must be regarded as settled beyond doubt or controversy that two states of this Union cannot by their joint action create a corporation which will be regarded as a single corporate entity and, for jurisdictional purposes, a citizen of each state which joined in creating it. One state may create a corporation of a given name, and the legislature of an adjoining state may declare that the same legal entity shall be or become a corporation of that state as well, and be entitled to exercise within its borders, by the same board of directors and officers, all of its corporate functions. Nevertheless, the result of such legislation is not

latures of two or more states undertake to consolidate corporations created by them respectively, as railroad companies or bridge companies. The result is several distinct corporations, for, as was said in an Illinois case, the legislatures of two states "have no power to unite in passing any legislative act. It is impossible, in the very nature of their organizations, that they can do so. They cannot so fuse themselves into a single sovereignty, and as such create a body politic which shall be a corporation of the two states, without being a corporation of each state or of either state."⁹⁴

Effect of doing business in another state.—As we shall see in treating of foreign corporations, corporations created by or under the laws of one state, while they can "live and have their being in that state only," may, by their duly-authorized agents, have an office, engage in business, take and hold property, and make contracts in another state with its express or implied consent. By doing so, however, they do not become in any sense citizens, residents, or inhabitants of the latter state, within the meaning of a statute defining the jurisdiction of courts, or other statutes, any more than a natural person, being a citizen of and residing in one state, would become a citizen or resident of another state by doing business therein through an agent. They remain citizens, residents, or inhabitants of the state of their creation, and of that state only.⁹⁵

to create a single corporation, but two corporations of the same name having a different paternity." And in each state there is a corporation which is a citizen of that state. *Missouri Pac. Ry. Co. v. Meech*, 32 U. S. App. 691, 69 Fed. 753, 30 L. R. A. 250. See, also, *Ohio & M. R. Co. v. Wheeler*, 1 Black (U. S.) 286, 17 L. Ed. 130; *Muller v. Dows*, 94 U. S. 444, 24 L. Ed. 207; *Nashua & L. R. Corp. v. Boston & L. R. Corp.*, 136 U. S. 356, 34 L. Ed. 363, 10 Sup. Ct. 1004; *Racine & M. R. Co. v. Farmers' Loan & Trust Co.*, 49 Ill. 331, 95 Am. Dec. 595; *Quincy Railroad Bridge Co. v. Adams County*, 88 Ill. 615; *Vaughan v. Nashville, C. & St. L. Ry.*, 192 Ky. 137, 232 S. W. 411, 18 A. L. R. 124, 142n. *Chicago & N. W. Ry. Co. v. Auditor General*, 53 Mich. 79, 18 N. W. 586; *Covington & C. Bridge Co. v. Mayer*, 31 Ohio St. 317; *Mobile & O. R. Co. v. Barnhill*, 91 Tenn. 395, 19 S. W. 21, 30 Am. St. Rep. 889. See 4 Columbia Law Review, 391;

Geoffroy v. New York, N. H. & H. R. Co., 13 Fed. (2d) 947.

⁹⁴ *Quincy Railroad Bridge Co. v. Adams County*, 88 Ill. 615. See, also, *Chicago & N. W. Ry. Co. v. Auditor General*, 53 Mich. 79, 18 N. W. 586; *Duncan v. St. Louis, I. M. & S. Ry. Co.*, 49 La. Ann. 1700, 22 So. 924; *Case v. Atlanta & C. A. Ry. Co.*, 225 Fed. 862; *Patch v. Wabash Ry. Co.*, 207 U. S. 277, 52 L. Ed. 204, 28 S. C. 80, 12 Ann. Cas. 518.

⁹⁵ *Baltimore & O. R. Co. v. Koontz*, 104 U. S. 5, 26 L. Ed. 643; *Shaw v. Quincy Min. Co.*, 145 U. S. 444, 36 L. Ed. 768, 12 Sup. Ct. 935; *Southern Pac. Co. v. Denton*, 146 U. S. 202, 36 L. Ed. 943, 13 Sup. Ct. 44; *Chafee v. Fourth Nat. Bank of New York*, 71 Me. 514, 36 Am. Rep. 345; *Baltimore & O. R. Co. v. Glenn*, 28 Md. 287, 92 Am. Dec. 688; *St. Louis & S. F. R. Co. v. James*, 161 U. S. 545, 40 L. Ed. 802, 16 Sup. Ct. 621; *Louisville, N. A. & C. R. Co. v. Louisville Trust Co.*, 174 U. S. 552, 43 L. Ed. 1081, 19 Sup. Ct. 817.

"By doing business away from their legal residence they do not change their citizenship, but simply extend the field of their operations. They reside at home, but do business abroad."⁹⁶

Distinction between a license and a charter from another state.—The fact that the legislature of a state passes a statute *licensing* a corporation created by or under the laws of another state to do business within its limits does not have the effect of creating a corporation, or make the corporation any the less a citizen and resident of the other state, and of that state only.⁹⁷ Whether or not a statute is a mere license or a charter depends, of course, upon the intention of the legislature, to be determined from the language of the statute, with the aid of the various rules governing the construction of statutes.⁹⁸

§ 8. When a corporation is a "person," "resident," "citizen," etc.—A corporation is a "person," "resident," "inhabitant," or "citizen," within the meaning of such terms in a constitutional or statutory provision, when it is within the reason and purpose of the provision, but not otherwise.

A corporation has repeatedly been held to be within a constitutional or statutory provision using the word "person," and not referring to corporations in express terms. The rule in this respect is that, when a constitutional or statutory provision confers a right or imposes a duty or liability upon any "person" generally, without referring to corporations, *eo nomine*, it applies to corporations, as well as to natural persons, if they are within its reason and purpose, and are not expressly excluded.⁹⁹ But they are not included if they are not within its reason and purpose.¹⁰⁰

⁹⁶ Baltimore & Ohio R. Co. v. Koontz, 104 U. S. 5, 26 L. Ed. 643.

⁹⁷ Baltimore & O. R. Co. v. Harris, 12 Wall. (U. S.) 65, 20 L. Ed. 354; St. Louis & S. F. R. Co. v. James, 161 U. S. 545, 40 L. Ed. 802, 16 Sup. Ct. 621; Vaughan v. Nashville, C. & St. L. Ry., 192 Ky. 137, 232 S. W. 411, 18 A. L. R. 124; Blue Ridge Power Co. v. Southern R. Co., 122 S. C. 222, 115 S. E. 306.

⁹⁸ Compare Baltimore & O. R. Co. v. Harris, 12 Wall. (U. S.) 65, 20 L. Ed. 354, and Grangers' Life & Health Ins. Co. v. Kamper, 73 Ala. 325. See Vaughan v. Nashville, C. & St. L. Ry., 192 Ky. 137, 232 S. W. 411, 18 A. L. R. 124, 130n.

⁹⁹ Union Steamship Co. v. Melbourne Harbor Trust Com'rs, 9 App.

Cas. 365; Crafford v. Supervisors of Warwick County, 87 Va. 110, 12 S. E. 147, 10 L. R. A. 129; People ex rel. New York H. & R. Co. v. Barker, 140 N. Y. 437, 35 N. E. 657; Ricker v. American Loan & Trust Co., 140 Mass. 346, 5 N. E. 284; Chapman v. Brewer, 43 Neb. 890, 61 N. W. 637, 47 Am. St. Rep. 779; Stewart v. Waterloo Turn Verein, 71 Iowa, 226, 32 N. W. 29, 60 Am. Rep. 786; Turnbull v. Prentiss Lumber Co., 55 Mich. 387, 21 N. W. 375; Willmott v. London Road Car Co., Ltd. [1910] 2 Ch. 525, 20 Ann. Cas. 733, 737n. Word "person" as including private corporation.

¹⁰⁰ Pharmaceutical Society v. London & Provincial Supply Ass'n, 5

A corporation is a "person," within the meaning of the fourteenth amendment of the federal constitution, prohibiting any state from depriving any person of life, liberty, or property without due process of law, or denying to any person within its jurisdiction the equal protection of the laws, and similar provisions in state constitutions prohibiting the legislature from depriving any person of his property without due process of law, etc.¹⁰¹ A corporation is not a "person" under the fifth amendment to the federal constitution that no person shall be compelled in any criminal case to be a witness against himself and does not enjoy the same immunity that individuals have from producing their books and records for examination before a federal grand jury engaged in investigating their conduct in relation to the federal criminal law.^{101a} A corporation is not a citizen, however, within the meaning of article four of the constitution of the United States, declaring that the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.¹⁰²

§ 9. Classification of corporations.—Corporations are variously classified as follows:

- (1) Sole and aggregate.
- (2) Eleemosynary and civil,—the former being created for the administration of charitable trusts, as in the case of endowed hospitals, asylums, colleges, libraries, and the like, while the latter are created for private gain or other civil purposes.
- (3) Public and private,—the former being created for public purposes, while the latter are created for private purposes.

App. Cas. 857. See Smith, 10 American Bar Ass'n Journal, 507, 508, 509.

¹⁰¹ Pembina Con. Silver Mining & Milling Co. v. Pennsylvania, 125 U. S. 181, 31 L. Ed. 650, 8 Sup. Ct. 737; Missouri Pac. R. Co. v. Mackey, 127 U. S. 205, 32 L. Ed. 107, 8 Sup. Ct. 1161; Railroad Tax Cases, 13 Fed. 722; San Mateo County v. Southern Pac. R. Co., 116 U. S. 138, 29 L. Ed. 589, 6 Sup. Ct. 317.

^{101a} Essgee Co. of China v. United States, 262 U. S. 151, 67 L. Ed. 917, 43 Sup. Ct. 514. It is however entitled to immunity under the fourth amendment against unreasonable searches and seizures without a valid search warrant. Hale v. Henkel,

201 U. S. 43, 50 L. Ed. 652, 26 Sup. Ct. 370. Admissibility of evidence attained through unreasonable search and seizure. Atkinson, 25 Columbia Law Rev. 11, 27.

¹⁰² Paul v. Virginia, 8 Wall. (U. S.) 168, 19 L. Ed. 357; Pembina Consol. Silver Mining & Milling Co. v. Pennsylvania, 125 U. S. 181, 31 L. Ed. 650, 8 Sup. Ct. 737; Ducat v. City of Chicago, 48 Ill. 172, 95 Am. Dec. 529, aff'd 10 Wall. (U. S.) 410, 19 L. Ed. 972; Tatem v. Wright, 23 N. J. Law, 429, 441. See St. Louis & S. F. R. Co. v. State, 120 Ark. 182, 179 S. W. 342, Ann. Cas. 1917 C 873, 876n.

- (4) **Corporations with full power and quasi corporations**,—the latter being persons or bodies having some, but not all, of the attributes of a corporation.
- (5) **Domestic and foreign**,—a foreign, as distinguished from a domestic, corporation, being a corporation created by or under the laws of some other country or state.
- (6) **Particular statutes sometimes further classify corporations**, according to their object or business, as banking, insurance, trading, mercantile, manufacturing, transportation, moneyed corporations, profit or non-profit, stock or non-stock, co-operative associations, etc.

Corporations sole.—Corporations have been classified into various kinds and species. Corporations aggregate are contrasted with corporations sole. Corporations sole came into the common law particularly to hold ecclesiastical property. They consisted of an officer and his successors, as a bishop, dean or parson. The conception of corporation sole was used to explain the distinction between the natural and political capacity of the king, as head and representative of the state. The corporation sole was a means of securing the continuity of holding of real property by an institution, and personifying a man's official or fiduciary capacity and severing it from his natural capacity.¹⁰³ A corporation sole was the creation of the common law for the purpose of some of the English institutions. At common law, the king was regarded as a corporation sole, with the capacity of succession, in order to prevent a possible interregnum, and to preserve the possessions of the crown.¹⁰⁴

And so it was with bishops, certain deans, parsons, and vicars.¹⁰⁵ In effect the ecclesiastical property was held under an official trusteeship. The church itself was not a corporate body and the parson had to act for it. The common law corporation sole was a very rudimentary sort of corporation, in effect a series of natural persons who held real property as trustees or officers and who suc-

¹⁰³ Carr, *Corporations*, pp. 14, 28-29; Costigan, *Cases on Trusts*, p. 306; *Overseers of Poor of Boston v. Sears*, 22 Pick (Mass.) 122; *Governor v. Allen*, 8 Humph. (Tenn.) 176; *Roman Catholic Archbishop of San Francisco v. Shipman*, 79 Cal. 288, 21 Pac. 830; *McCloskey v. Doherty*, 97 Ky. 300, 30 S. W. 649, 17 Ky. Law Rep. 178. See Maitland, *The*

Corporation Sole, 16 Law Quar. Rev. 335, 353-354; Freund, *Legal Nature of Corporations*, § 22, p. 36; *Howley v. Knight*, 14 Q. B. 240; Gray, *Nature & Sources of Law*, 135; *Mulliner v. Midland Ry. Co.*, 11 Ch. D. 611, 622.

¹⁰⁴ Co. Litt. 43; 1 Bl. Com. 469.

¹⁰⁵ 1 Bl. Com. 469. See Ford v. Harrington, L. R. 5 C. P. 282.

ceeded to the title without the formalities of a transfer. In the United States, corporations sole are rarely met with, and in some states, perhaps, they are not recognized at all apart from statute, but there are a few reported cases in which they have been recognized. In an early Massachusetts case, the minister of a parish, who was seised of parsonage lands in right of his parish, was held to be a corporation sole, in accordance with the English law, so that he could sue as such to recover possession of the same.¹⁰⁶ In an early California case it was held that the priest of a Catholic mission was in a position, with respect to lands of the mission, analogous to that of a corporation sole in England, and that he could maintain an action in his character of priest to recover possession.¹⁰⁷ And in two cases, one in California and the other in Kentucky, it was held that a Catholic bishop or archbishop was a sole corporation with respect to lands held by him in such character.¹⁰⁸ By statute in some states real corporate capacity has been conferred on certain corporations sole.¹⁰⁹ The fact that all the shares in a corporation aggregate become vested by transfers in a single individual does not make it a corporation sole, but it retains its original character, for the several shares are treated as remaining distinct, and may at any time be redistributed by the holder.¹¹⁰

Eleemosynary and civil corporations.—Eleemosynary corporations are such as are created, not for private gain or profit, but for charitable purposes,—for the administration of charitable trusts. For this reason they are sometimes called “charitable corporations.” Corporations created for the purpose of maintaining hospitals and homes for the sick, insane and poor, or for the purpose of maintaining endowed libraries or colleges, are “eleemosy-

¹⁰⁶ *Weston v. Hunt*, 2 Mass. 500 (statute). See *governor v. Allen*, 8 Humph. (Tenn.) 176; *Roman Catholic Archbishop of San Francisco v. Shipman*, 79 Cal. 288, 21 Pac. 830.

¹⁰⁷ *Santillan v. Moses*, 1 Cal. 92.

¹⁰⁸ *Roman Catholic Archbishop of San Francisco v. Shipman*, 79 Cal. 288, 21 Pac. 830; *McCloskey v. Doherty*, 97 Ky. 300. In Illinois, the Catholic bishop of Chicago was created a corporation sole by statute. See *Chiniquy v. Catholic Bishop of Chicago*, 41 Ill. 148.

¹⁰⁹ *Roman Catholic Archbishop v.*

Industrial Accident Commission, 194 Cal. 660, 230 Pac. 1; *Calif. Civil Code*, secs. 602–602b, officer of religious society may become corporation sole with continuous existence.

¹¹⁰ *Russell v. McLellan*, 14 Pick. (Mass.) 63, 69; *Newton Mfg. Co. v. White*, 42 Ga. 148, 159; *Baldwin v. Canfield*, 26 Minn. 43, 1 N. W. 261, 276; *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 21 S. W. 531, 1049, 19 L. R. A. 684, 42 Am. St. Rep. 335. See as to “one man companies,” § 6 ante; § 257, post.

nary" or "charitable," as distinguished from "civil," corporations.¹¹¹

Public and private corporations.—A public corporation, it has been said, is one that is created for a political purpose, with political power, to be exercised for purposes connected with the public good in the administration of civil government. It is an instrument of the government subject to the control of the legislature, and its members are officers of the government appointed for the discharge of public duties.¹¹² In other words, a public corporation is a corporation created merely for purposes of government, and a private corporation is one that is created for other purposes than those of government.¹¹³ But the terms public and private companies are now used in English and Canadian legislation to indicate an entirely different classification.¹¹⁴

¹¹¹ *Dartmouth College v. Woodward*, 4 Wheat. (U. S.) 518, 4 L. Ed. 629; *Durant v. Kennett*, L. R. 5 C. P. 262; *American Asylum v. Phoenix Bank*, 4 Conn. 172, 10 Am. Dec. 112; *McDonald v. Massachusetts General Hospital*, 120 Mass. 432, 21 Am. Rep. 529.

¹¹² *McKim v. Odom*, 3 Bland Ch. (Md.) 407; *Regents of University of Maryland v. Williams*, 9 Gill & J. (Md.) 365, 31 Am. Dec. 72. And see *Downing v. Indiana State Board of Agriculture*, 129 Ind. 443, 28 N. E. 123, 614, 12 L. R. A. 664; *People v. Morris*, 13 Wend. (N. Y.) 325. See *Providence Engineering Corp. v. Downey Shipbuilding Corp.*, 294 Fed. 641.

The general and fundamental division of all corporations is into public and private. Public corporations, commonly called municipal corporations, are not associations, but subdivisions of the state. *Phillips v. Baltimore*, 110 Md. 431, 72 Atl. 902, 25 L. R. A. (N. S.) 711.

¹¹³ *Dartmouth College v. Woodward*, 4 Wheat. (U. S.) 518, 4 L. Ed. 629; *State ex rel. Clark v. Maryland Institute for Promotion of Mechanic Arts*, 87 Md. 643, 41 Atl. 126; *Phillips v. Rector et al.*, of University of Virginia, 97 Va. 472, 34 S. E. 66, 47 L. R. A. 284; *Maia's Adm'r v. Eastern State Hospital*, 97 Va. 507, 34 S. E. 617, 47 L. R. A. 577; *City of Louisville v. University of Louisville*, 15 B. Mon. (Ky.) 642.

¹¹⁴ Mr. S. R. Wrightington states the English and Canadian method of classifying corporations as public and private, as based on those which do or do not seek capital by public solicitation. 10 Am. Bar Ass'n Journal, 47 (July, 1924): "The terms 'public' and 'private' companies in the Companies Act have a significance different from the use of the terms in the United States. Public companies are not merely public service corporations, but all companies of large numbers of stockholders or companies whose capital is obtained by public solicitation. All other companies are private companies. In 1921 in England out of 6,834 companies registered under the Companies Act of 1908, 6,293 were private companies.

The principal requirements which distinguish private from public companies under the Companies Act of 1908 are as follows: 1. Membership limited to fifty. 2. Transfer of shares restricted. 3. Public solicitation of capital forbidden.

A company with these stipulations in its articles may be formed by as few as two persons.

The restriction on transfer of shares which is required is complied with by a stipulation requiring prior offer to the corporation or the directors like those common in closely held corporations in this country.

It is submitted that a similar classification of corporations and

Among the corporations which are clearly public are incorporated cities, villages, and towns, commonly called "municipal corporations."¹¹⁵ A corporation may be public if created for a public purpose, although not political or municipal, if the whole interest belongs to the government, as in the case of purely public banks or a state university. But a government, engaging in a particular business through the instrumentality of a corporation may divest itself of its sovereign character, so as to render the corporation liable like a private corporation.¹¹⁶ Hospitals, colleges, universities, academies, and other educational corporations are public if they are exclusively endowed and controlled by the state,¹¹⁷ but not otherwise. State universities, so called, or other educational institutions, or hospitals and asylums founded by private donors for the purposes of general charity, are not public corporations merely because the state has made an appropriation or donation of money or land for their benefit, or because, in doing so, it has imposed conditions for the benefit of the public, or reserved some power of control over the conduct of their affairs.¹¹⁸

Quasi public corporations.—Public service corporations are organized for a purpose which is of a public nature, or rather for a purpose which renders them particularly beneficial, if not necessary, to the public, and are for this reason called *quasi* public corporations; and, because of their *quasi* public nature, they are sometimes given rights and privileges that are not accorded to other corporations,—as the right of eminent domain, for example. Rail-

trusts with transferable shares is desirable in this country and that it would permit the limitation of the application of much legislation now burdening private business to what the English call Public Companies."

Private and public companies, Halsbury's Laws of England, vol. V, pp. 71-74; *In re White*, [1913] 1 Ch. 231.

¹¹⁵ *City of Hagerstown v. Sehner*, 37 Md. 180, 193; *People v. Morris*, 13 Wend. (N. Y.) 325.

¹¹⁶ *Sloan Shipyards Corp. v. United States Shipping Board Emergency Fleet Corp.*, 258 U. S. 549, 66 L. Ed. 762, 42 Sup. Ct. 386, 56 American Law Rev. 786; *Sargent County v. State*, 47 N. D. 561, 182 N. W. 270; *Providence Engineer Corp. v. Downey Shipbuilding Corp.*, 294 Fed. 641,

646. Fleet Corporation is a private business corporation, although U. S. owned all the stock. See ante, § 5.

¹¹⁷ *Trustees of University of Alabama v. Winston*, 5 Stew. & P. (Ala.) 17; *Phillips v. Rector, etc., of University of Virginia*, 97 Va. 472, 34 S. E. 66, 47 L. R. A. 284; *Maia's Adm'r v. Eastern State Hospital*, 97 Va. 507, 34 S. E. 617, 47 L. R. A. 577; *Spalding v. People*, 172 Ill. 40, 49 N. E. 993.

¹¹⁸ *Trustees of Dartmouth College v. Woodward*, 4 Wheat. (U. S.) 518, 4 L. Ed. 629; *Board of Trustees of Vincennes University v. Indiana*, 14 How. (U. S.) 268, 14 L. Ed. 416; *State v. Carr*, 111 Ind. 335, 12 N. E. 318; *Regents of University of Maryland v. Williams*, 9 Gill & J. (Md.) 365; *City of Louisville v. University of Louisville*, 15 B. Mon. (Ky.) 642.

road companies engaged in the common carriage of passengers and goods are *quasi* public corporations in this sense. And the same is true of water and gas corporations created for the purpose of supplying cities or villages and their inhabitants with water or light. These corporations, though because of their objects they are called *quasi* public, are created for private gain, and are mere private corporations, just as a banking company or insurance company is a mere private corporation.

The United States and the states and territories as corporations.—In England, for the purposes of succession, and to preserve the possessions of the crown, the king was regarded as a corporation sole at common law. And in this country, the United States is a corporation or body corporate, for it may, as an artificial person, enter into contracts, take, hold, and convey property, and sue, and, if it consents, be sued.¹¹⁹ The same is true of the different states of the Union.¹²⁰ A state, said the New York court, “is a legal being, capable of transacting some kinds of business like a natural person, and such a being is a corporation.”¹²¹

Quasi corporations.—Some bodies are created with full corporate powers, while others are not. The latter are called “*quasi* corporations.” Incorporated cities and villages are clothed with full corporate powers, and are corporations in the proper sense. A county, on the other hand, or a board of county commissioners representing the county, is not clothed with full corporate powers, but it may exercise corporate powers for some purposes,—as for the purpose of holding property and making contracts for county purposes, and for the purpose of suing and being sued. Because of its imperfect powers, it is not a corporation in the proper sense, but, because it has some corporate powers, it is a *quasi* corporation.¹²² If public officers or public boards such as boards of county commissioners, school trustees, boards of education, trustees of the

¹¹⁹ *Respublica v. Sweers*, 1 Dall. (Pa.) 41; *Dugan v. United States*, 3 Wheat. (U. S.) 172, 4 L. Ed. 362; *Dickson v. United States*, 125 Mass. 311, 28 Am. Rep. 230.

¹²⁰ *State of Indiana v. Woram*, 6 Hill (N. Y.) 33, 40 Am. Dec. 378. See, also, *People v. City of St. Louis*, 10 Ill. 351, 48 Am. Dec. 339; *City of Indianapolis v. Indianapolis Water Co.*, 185 Ind. 277, 113 N. E. 369.

¹²¹ *State of Indiana v. Woram*, 6 Hill (N. Y.) 33, 40 Am. Dec. 378.

¹²² *Breathitt Co. v. Hagins*, 183 Ky. 294, 207 S. W. 713; *Board of Com'rs Osborne Co. v. City of Osborne*, 104 Kan. 671, 180 Pac. 233; *Talbot County Com'rs v. Queen Anne's County Com'rs*, 50 Md. 245; *Slaughter v. Mobile County*, 73 Ala. 134. See *Hamilton County Com'rs v. Mighels*, 7 Ohio St. 109. So also, school districts and road districts.

poor and the like, are given the power to make contracts in reference to public affairs, and are clothed with the capacity of succession, they are *quasi* corporations, and as such they have, without an express grant of authority, the capacity to "sue and be sued in regard to any matter in which, by law, they have rights to be enforced, or are under obligations which they refuse to fulfill."¹²³

Domestic and foreign corporations.—A corporation created by or under the laws of a particular state or country is called, with respect to that state or country, a "domestic corporation." A foreign corporation is one which owes its existence to the laws of another country or state. The distinction is not based upon any difference in the nature of corporations, but upon status merely.¹²⁴

Statutory classification of corporations.—In a number of states the corporation laws classify corporations according to their nature or objects, into "moneyed" corporations, "business corporations," "transportation corporations," "manufacturing," "trading," and "mercantile" corporations, "religious," "charitable," or "benevolent" corporations, "banking" corporations, "public utility" corporations, corporations for pecuniary profit, non-profit corporations and co-operative associations. Corporations are also thus variously classified or referred to in other statutes relating to corporations, such as statutes taxing corporations, or exempting them from taxation, statutes imposing a liability upon stockholders or officers, etc. The courts, therefore, are frequently called upon to construe such terms, and to determine whether or not they apply to particular corporations. The character of a corporation—whether it is a "manufacturing" corporation, or a "trading" corporation, or a "benevolent" corporation, etc.—is to be determined usually from its charter.¹²⁵ Stock or joint stock corporations are contrasted with non-stock or membership corporations, according to whether they issue certificates of stock to their members or not. In the case of non-stock corporations the membership is not ordinarily transferable, and one who dies or ceases to be a member for any cause loses his interest in the corporation and its assets.¹²⁶

¹²³ *Levy Court v. Woodward*, 2 Wall. (U. S.) 501, 17 L. Ed. 851; *Trustees of Schools v. Tatman*, 13 Ill. 27; *Polk v. Plummer*, 2 Humph. (Tenn.) 500, 37 Am. Dec. 566; *Jansen v. Ostrander*, 1 Cow. (N. Y.) 670.

¹²⁴ See post, § 285 et seq., chap. 22.

¹²⁵ For a full collection of the cases construing particular terms, and determining whether they apply to certain corporations, see *Fletcher, Corp.* §§ 84–102.

¹²⁶ *Union Benev. Soc. No. 8 v. Martin*, 113 Ky. 25, 67 S. W. 38; *Clearwater Citrus Growers' Ass'n v. Andrews*, 81 Fla. 299, 87 So. 903.

Co-operative associations have been provided for under the statutes of most of the states, particularly in connection with agriculture, for productive, marketing and distributive purposes. The purpose is that the producers or consumers may get the benefit of the enterprise without speculative profit to those who contribute the capital or act as middlemen.¹²⁷

¹²⁷ McClure v. Co-operative El. & S. Co., 105 Kan. 91, 181 Pac. 573; Mooney v. Farmers' M. & El. Co., 138 Minn. 199, 164 N. W. 804; Chaffee v. Farmers' Co-op. El. Co., 39 N. D. 585, 168 N. W. 616; Ballantine, Co-operative Ass'ns, 8 Minnesota Law Review 1; 31 C. J. 961, Industrial Co-operative Societies; see also titles, Agriculture and Associations.

CHAPTER II.

CREATION OF CORPORATIONS; NAME; EXTENSION AND REVIVAL OF CHARTERS.

§ 9a. How corporations may be created.—Corporations cannot, like a partnership, be formed by mere agreement between the associates. They can be created only by or under special authority from the sovereign or state.

(1) In England corporations could be created or exist.

(a) By prescription.

(b) By royal charter.

(c) By act of parliament.

(2) In the United States they can now be created or exist only by federal or state statute.

The consent of the sovereign power—the state or the United States, as the case may be, acting through the legislative department—is necessary to the existence of a corporation. Ordinary partnerships, unincorporated societies and clubs, and joint-stock companies may be organized by the mere voluntary agreement and association of the individuals who compose them; but the right to be a corporation is a franchise, and a corporation, however lawful or commendable its purpose, cannot be created by the mere voluntary association of its members. Legislative authority is absolutely essential.¹

Corporations by royal charter or act of parliament.—In England, corporations were created by royal charter,—that is, by a grant from the king himself. At first this was the only mode in which corporations were expressly created. Afterwards they were created by act of parliament, either general or special. In 1844 an act provided that a company might be constituted by registration. Since the great Companies Act of 1862, any two or more persons associated for any lawful purpose may by subscribing their

¹ Turner v. Turner Mfg. Co., 184 393; Spotswood v. Morris, 12 Idaho Wis. 508, 199 N. W. 155; State v. 360, 85 Pac. 1094, 6 L. R. A. (N. S.) Cosgrove, 36 Idaho 278, 210 Pac. 665.

names to a memorandum of association form an incorporated company. The Companies (Consolidation) Act of 1908 consolidated all previous legislation relating to limited companies.²

§ 10. Power of the legislature to create corporations—In general. The powers of the state and federal legislatures to create corporations in the United States differ:

- (1) State legislatures are generally forbidden to create corporations by special acts.
- (2) Congress has the power to create corporations only in so far as such power has been conferred upon it, expressly or impliedly, by the Constitution of the United States.
 - (a) Under its power to legislate for the District of Columbia, it has full power to create corporations in the District.
 - (b) Under its power to legislate for the territories, it has full power to create corporations therein.
 - (c) Under its power to legislate for the United States, it has the power to create a corporation, if the corporation is necessary or proper in order to carry into execution any power conferred by the Constitution upon the government of the United States, or upon any department or officer thereof.

General and special laws.—State legislatures have plenary power to create corporations. Formerly, corporations were created exclusively by special acts,—that is, by acts creating a particular corporation, as distinguished from a general law allowing any persons to organize themselves into and be a corporation by complying with prescribed conditions; and corporations may still be created by special act, in the absence of a constitutional prohibition. Corporations may also be created under the authority of general laws. In most of the states, in order to remove the danger of favoritism and corruption in the creation of corporations, the people have adopted constitutional provisions declaring that, with certain exceptions, the legislature shall not pass any special act

² See Palmer, *Company Law* (11th ed.) pp. 1, 5, 7; Halsbury's *Laws of England*, vol. 5, pp. 13, 25, 744; vol. 8, p. 314.

There is a fundamental difference between a chartered company and a company formed by special act or

registered under the Companies Act, namely that the former has unrestricted corporate capacity and the latter special capacity limited to its authorized objects. *Edwards v. Blackmore*, 42 Ont. L. R. 105, 42 Dom. Law Rep. 280.

creating a corporation, but that corporations shall be formed under general laws only; and where there is such a prohibition, a special act creating a corporation is absolutely void.³ Formerly when a corporation was to be organized a private bill had to be introduced in the legislature, referred to a committee, passed through both houses and signed by the governor of the state. Delay, expense and corruption often resulted. General incorporation laws now make it possible for almost any enterprise to be conducted in corporate form upon compliance with simple formalities. In fact the restrictions are often most lax owing to the competition between the states for the business of granting charters, and collecting incorporation fees and franchise taxes.⁴ The fact that an act authorizing the formation of corporations or conferring powers or privileges upon corporations does not apply to every person or corporation in the state does not render the act special, if it makes a reasonable classification, and has a uniform operation as to all persons similarly situated.⁵

§ 11. Power of congress to create corporations.

Unlike the state legislatures, congress has no general power to create corporations, for its powers of legislation are such only as are conferred upon it by the constitution of the United States. That instrument, in addition to conferring upon congress various specific powers, provides that it shall have the power "to make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this constitution in the government of the United States, or in any department or officer thereof." Under this provision, congress has the power to create a corporation whenever the corporation is a necessary or proper means for carrying into execution any power which is conferred by the constitution upon the government of the

³ City & County of San Francisco v. Spring Valley Water Works, 48 Cal. 493; School Dist. No. 56 v. St. Joseph Fire & Marine Ins. Co., 103 U. S. 707, 26 L. Ed. 601; Oroville & V. R. Co. v. Plumas County Sup'rs, 37 Cal. 354; Wells Fargo & Co. v. Northern Pac. Ry. Co., 23 Fed. 469; Davis v. Allison, 109 Tex. 440, 211 S. W. 980.

⁴ In 1811 the New York legislature passed a general law for the formation of stock corporations for various manufacturing purposes, the first

of its kind in America. Great distrust was felt in the experiment of granting general permission for the organization of companies with limited personal liability. Only 95 corporations were formed under it during the first five years. In 1923, 19,533 certificates of incorporation were filed in the office of the Sec'y of State of N. Y.

⁵ Attorney General v. McArthur, 38 Mich. 204; State v. Parsons, 40 N. J. Law, 1.

United States, or upon any department or officer thereof, such as the power to regulate interstate commerce.⁶ In no other case has it any power to create a corporation when acting as the legislature of the United States.

Since the constitution gives congress exclusive legislative jurisdiction over the District of Columbia, it has the same power to create corporations therein as a state has to create corporations in the state.⁷ And under its general constitutional power to legislate for the territories of the United States, congress has the same power to create corporations in a territory as a state legislature has to create corporations in the state, subject only to such restrictions as are to be found in the federal constitution.⁸

Congress may not only itself create corporations in the territories of the United States, but it may also authorize the legislature of a territory to do so.⁹ A corporation created under the laws of a territory becomes a corporation of the state when the territory is admitted into the Union.¹⁰

§ 12. Consent of corporators, or acceptance of charter.—To bring a private corporation into existence, there must be consent on the part of the corporators, as well as the special authority from the state, and a charter from the state, therefore, does not create a private corporation until it is accepted by the corporators in accordance with its terms. Such acceptance, however, may be implied from the exercise of corporate powers under the charter.

A public corporation, being a mere instrument of government, may be created by the legislature without the consent of the mem-

⁶ *McCulloch v. Maryland*, 4 Wheat. (U. S.) 316, 4 L. Ed. 579; *Luxton v. North River Bridge Co.*, 153 U. S. 525, 38 L. Ed. 808, 14 Sup. Ct. 891; *Smith v. Kansas City Title & Trust Co.*, 255 U. S. 180, 65 L. Ed. 577, 41 Sup. Ct. 243.

On federal incorporation, see 17 *Michigan Law Rev.* 64, 145, 238-260; 26 *Yale L. Journ.* 207, 667; 30 *Harvard Law Review*, 589; 32 *Harv. Law Rev.* 689; 5 *California Law Rev.* 273.

⁷ *Stoutenburgh v. Hennick*, 129 U. S. 141, 32 L. Ed. 637, 9 Sup. Ct. 256; *Hadley v. Freedman's Sav. & Trust Co.*, 2 Tenn. Ch. 122; *Williams v. Creswell*, 51 Miss. 817; *Close v. Glenwood Cemetery*, 107 U. S. 466, 27 L. Ed. 408, 2 Sup. Ct. 267.

⁸ See *Riddick v. Amelin*, 1 Mo. 5; *Williams v. Bank of Michigan*, 7 Wend. (N. Y.) 539; *Layden v. Endowment Rank K. P. of World*, 128 N. C. 546, 39 S. E. 47.

⁹ *Rogers v. Burlington*, 3 Wall. (U. S.) 654, 18 L. Ed. 79; *Riddick v. Amelin*, 1 Mo. 5; *Williams v. Bank of Michigan*, 7 Wend. (N. Y.) 539; *Binns v. United States*, 194 U. S. 486, 48 L. Ed. 1087, 24 Sup. Ct. 816.

¹⁰ *Vance v. Farmers' & Mechanics' Bank*, 1 Blackf. (Ind.) 80; *Kansas Pac. R. Co. v. Atchison, T. & S. F. R. Co.*, 112 U. S. 414, 28 L. Ed. 794, 5 Sup. Ct. 208; *Shulthis v. McDougal*, 225 U. S. 561, 56 L. Ed. 1205, 32 Sup. Ct. 704.

bers, but it is very different in the case of a private corporation. To the existence of such a corporation the consent of the members is essential, and therefore the grant or offer of a charter by the legislature does not create such a corporation until it is expressly or impliedly accepted by the incorporators. This is true particularly when the offer of a charter is by special act.¹¹ The incorporators under a general act give their assent in advance, while incorporation under a special act is not deemed complete until formal organization or assent by the doing of corporate acts.¹²

"The charter of a corporation consists of the certificate or articles of incorporation together with the laws under which it was organized. The charter evidences the contract by which the stockholder, by becoming such, consents to be bound. It measures and determines his rights, obligations and liabilities, and also the nature and extent of the powers conferred on the corporation, and defines and limits the field of corporate activities." ¹³

Mode and place of acceptance.—In the absence of special requirements in the statute, it is not necessary that the acceptance of a charter shall be shown by a formal act, but it may be shown either by an express act of acceptance, or by implication from the exercise or user of powers under the charter.¹⁴

Since, as we shall hereafter see, a corporation can do no acts outside of the state except such as it may do through its agents, it has been held that a charter must be accepted within the limits of the state by which it is granted, and that, if the incorporators or persons named as directors, who are authorized to accept a char-

¹¹ *State v. Dawson*, 16 Ind. 40; *Yeaton v. Bank of Old Dominion*, 21 Grat. (Va.) 593; *Lincoln & Kennebec Bank v. Richardson*, 1 Me. 79, 81, 10 Am. Dec. 34; *Ellis v. Marshall*, 2 Mass. 269, 3 Am. Dec. 49; *Cahill v. Kalamazoo Mut. Ins. Co.*, 2 Doug. (Mich.) 124, 43 Am. Dec. 457; *Glymont Improvement & Excursion Co. v. Toler*, 80 Md. 278, 30 Atl. 651; *In re Metropolitan Transit Co.*, 111 N. Y. 588, 603, 19 N. E. 645; *In re Julliard's Will*, 207 N. Y. App. Div. 478, 202 N. Y. S. 429.

¹² Acceptance of the charter under a general act is given in advance by signing articles of incorporation. *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454; *Smith v. Satilla Pecan Orchard &*

Stock Co., 152 Ga. 538, 110 S. E. 303.

¹³ *State ex rel. Hilton v. Mortgage Security Co.*, 154 Minn. 453, 192 N. W. 348. "Charter" denotes its articles of incorporation together with statutes applicable which determine its powers. *City of Danville v. Danville Water Co.*, 178 Ill. 299, 53 N. E. 118, 69 Am. St. Rep. 304; *McLeod v. Lincoln Medical College*, 69 Neb. 550, 96 N. W. 265, 98 N. W. 672.

¹⁴ *Glymont Improvement & Excursion Co. v. Toler*, 80 Md. 278, 30 Atl. 651; *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454. See *Davis v. Allison*, 109 Tex. 440, 211 S. W. 980; s. c., 189 S. W. 968.

ter, meet and accept it in another state, the acceptance will have no effect.¹⁵ Since, however, acceptance of a charter may be implied from the exercise or user of corporate powers, without any formal vote or resolution, in the absence of special requirements, acceptance within the state may be implied from the exercise of corporate powers within the state; and in such a case the fact that there was a formal acceptance at a meeting held in another state is immaterial.¹⁶

§ 13. Who may become corporators.—Corporators under a general law must have the capacity to contract; but no other qualifications are necessary unless expressly required by the statute. In the absence of provisions in the statute to the contrary, a corporation may be formed—

- (1) By nonresidents or aliens, as well as residents and citizens.
- (2) By other corporations, as well as natural persons. But a corporation cannot become a member of another corporation unless its charter expressly or impliedly authorizes it to do so.
- (3) An infant cannot be a corporator, as he has no capacity to bind himself by contract.
- (4) Corporators need not be shareholders unless this is required by the statute.

In many states, the general laws authorizing the formation of corporations expressly provide that a certain number at least of the corporators shall be citizens or residents of the state, and the provision is mandatory; but in the absence of an express requirement to this effect, none of the corporators need be either citizens or residents.¹⁷ Where residence only is required, citizenship is not necessary.¹⁸

Ordinarily a corporation, unless expressly authorized, has no power to subscribe for or hold shares in another corporation, for

¹⁵ *Smith v. Silver Val. Min. Co.*, 64 Md. 85, 20 Atl. 1032, 54 Am. Rep. 760. *Hening & Hagedorn v. Glanton*, 27 Ga. App. 339, 108 S. E. 256. *Contra*, *Heath v. Silverthorn Lead Mining & Smelting Co.*, 39 Wis. 146.

¹⁶ *Glymont Improvement & Excursion Co. v. Toler*, 80 Md. 278, 30 Atl. 651.

¹⁷ *Moxie Nerve Food Co. v. Baumbach*, 32 Fed. 205; *Central R. Co. v. Pennsylvania R. Co.*, 31 N. J. Eq.

475; *Demarest v. Flack*, 128 N. Y. 205, 28 N. E. 645, 13 L. R. A. 854; *Lancaster v. Amsterdam Imp. Co.*, 140 N. Y. 576, 35 N. E. 964, 24 L. R. A. 322. Only eighteen states require that at least one incorporator shall be a resident. 35 states have no residence requirement, and there seems no practical need of one.

¹⁸ *Moxie Nerve Food Co. v. Baumbach*, 32 Fed. 205; *Humphreys v. Mooney*, 5 Colo. 282.

this is generally unnecessary to enable it to accomplish the purposes for which it was created, and a corporation, as we shall see, cannot lawfully engage in transactions which are foreign to the purposes for which it was created.¹⁹ A corporation, however, may be expressly authorized by its charter to acquire and hold shares in other corporations, and it may then do so by subscribing for stock in the organization of another corporation, and thus become a corporator.²⁰ Statutes providing for the formation of corporations are not to be construed as authorizing other corporations to become corporators, unless such an intention on the part of the legislature is clear.²¹ Some states require incorporators to be "natural persons," and others require them to be of "full age" or "adults," which would exclude corporations.

Unless expressly permitted by the statute, an infant cannot become one of the corporators in forming a corporation, for at common law he is incapable of making a binding contract. Infants need not be expressly excluded by the statute, for it will be presumed that the legislature, in authorizing persons to form a corporation, contemplated such persons only as are *sui juris*.²²

The corporators need not be subscribers for stock in the proposed corporation, unless it is expressly so required by the statute.²³

¹⁹ *Denny Hotel Co. v. Schram*, 6 Wash. 134, 32 Pac. 1002, 36 Am. St. Rep. 130; *Franklin Co. v. Lewiston Institution for Savings*, 68 Me. 43, 28 Am. Rep. 9; *Converse v. Emerson Talcott & Co.*, 242 Ill. 619, 90 N. E. 269; *Herman v. Brooklyn Sav. Bank*, 196 N. Y. App. Div. 269, 187 N. Y. Supp. 738; *Nassau Bank v. Jones*, 95 N. Y. 115, 47 Am. Rep. 14. But see *Farmers' State Bank v. Richter*, 48 N. D. 1233, 189 N. W. 242.

²⁰ See *Iowa Lumber Co. v. Foster*, 49 Iowa 25, 31 Am. Rep. 140; *In re Asiatic Banking Corp.*, L. R. 4 Ch. App. 252; post, § 65. But see *American Ball Bearing Co. v. Adams*, 222 Fed. 967. The power to own stock in a going corporation is entirely different from the power to create a corporation.

²¹ *Knowles v. Sandercock*, 107 Cal. 629, 642, 40 Pac. 1047; *Factors' & Traders' Ins. Co. v. New Harbor Protection Co.*, 37 La. Ann. 238;

Central R. Co. v. Pennsylvania R. Co., 31 N. J. Eq. 475; *Denny Hotel Co. v. Schram*, 6 Wash. 134, 32 Pac. 1002, 36 Am. St. Rep. 130; *American Ball Bearing Co. v. Adams*, 222 Fed. 967.

²² *In re Globe Mut. Benev. Ass'n*, 63 Hun (N. Y.) 263, 17 N. Y. Supp. 852, aff'd 135 N. Y. 280, 32 N. E. 122, 17 L. R. A. 547. As to married women, see *Good Land Co. v. Cole*, 131 Wis. 467, 110 N. W. 895, 120 Am. St. Rep. 1056, 11 Ann. Cas. 806.

²³ *In re British Provident L. & G. Ass'n*, 5 Ch. Div. 306; *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43; *Bristol Bank & Trust Co. v. Jonesboro Banking Trust Co.*, 101 Tenn. 545, 48 S. W. 228; *Badger Paper Co. v. Rose*, 95 Wis. 145, 70 N. W. 302, 37 L. R. A. 162; *State v. Miner*, 233 Mo. 312, 135 S. W. 483. See *American Ball Bearing Co. v. Adams*, 222 Fed. 967; *Moe v. Harris*, 142 Minn. 442, 172 N. W. 494.

§ 14. Number of corporators.—No particular number of corporators is necessary in the formation of a corporation, unless a certain number is expressly or impliedly required by the statute.

In the absence of constitutional prohibitions, there is nothing to prevent a state from creating or authorizing a corporation composed of a single person only. In a Maine case it was held that a grant of corporate powers to one person, *and his associates and successors*, did not require of such person that he should take associates before the act could take effect or corporate powers be exercised, but that it virtually conferred upon him alone the right to exercise all the corporate powers thereby granted.²⁴ Although the state may thus create a corporation consisting of a single member only, it is not customary to do so in the case of a private business corporation; and for this reason the statutes authorizing the formation of corporations usually require three or more corporators. When this is the case, the provision is mandatory, and a corporation cannot be legally formed by less than the prescribed number.²⁵ Where a statute provided that “*any* number of persons” might “associate themselves together and become incorporated for the transaction of any lawful business,” it was held that it did not mean that a person could form a corporation consisting of himself only, but that he must have at least one associate.²⁶

§ 15. Organization of corporations.—In organizing a corporation, there must, to create a corporation *de jure*, as distinguished from a corporation *de facto*, be at least a substantial compliance with all conditions precedent prescribed by the act.

The requirements for incorporation vary, of course, in the different states, and under different statutes in the same state.

In most states, the persons forming a corporation under the general laws are required to prepare and sign a memorandum, certificate, or articles of association, and generally they must acknowledge the same before a notary. Substantial compliance

²⁴ *Penobscot Boom Corp. v. Lamson*, 16 Me. 224, 33 Am. Dec. 656. Three or more incorporators are required in all except the following states: Iowa, Neb., one; Ariz., Ga., Miss., S. C. and Wash., 2; Hawaii, Kan., Ohio, Philippine Islands, Tenn., Utah and W. Va., 5.

²⁵ *Rex v. Amery*, 1 Term R. 589, 2 Term R. 515. *Broderip v. Salmon*, [1895] 2 Ch. Div. 323; *Mont-*

gomery v. Forbes, 148 Mass. 249, 19 N. E. 342; *State v. Critchett*, 37 Minn. 13, 32 N. W. 787; *People v. Montecito Water Co.*, 97 Cal. 276, 32 Pac. 236, 33 Am. St. Rep. 172.

²⁶ *Louisville Banking Co v. Eisenman*, 94 Ky. 83, 21 S. W. 531, 1049, 19 L. R. A. 684, 42 Am. St. Rep. 335. See *Swift v. Smith*, 65 Md. 428, 5 Atl. 534, 57 Am. Rep. 336.

with these provisions is essential to create a corporation *de jure*.²⁷ The memorandum, certificate, or articles must also comply substantially with the requirements of the statute as to their contents,—as that they shall state the name and objects of the proposed corporation and the nature of the business which it is authorized to conduct.²⁸ This is intended for the protection of those who become stockholders in order that they may determine the risks and hazards to which their capital may be exposed. Other matters to be stated in the articles include the location of its principal place of business,²⁹ the amount of the capital stock, the number of shares, the amount subscribed, and names and residences of subscribers, the amount paid in, etc.³⁰ Limitations on the amount of indebtedness which may be incurred, as that it shall be a certain percentage of the amount of stock subscribed, or a definite specified amount, may be imposed.³¹ Statutes often require or permit the articles to state the number, names and residences of the directors or trustees for the first year.³²

Under some statutes it is not necessary that the capital stock of a corporation shall be paid, or even subscribed, before the corporation is organized;³³ while under others, all or a part of the stock must be subscribed as a condition precedent to valid corporate existence;³⁴ and under some, all or part must be actually paid

²⁷ Utlely v. Union Tool Co., 11 Gray (Mass.) 139; Boyce v. Towsontown Station of M. E. Church, 46 Md. 359; Kaiser v. Lawrence Sav. Bank, 56 Iowa 104, 8 N. W. 772, 41 Am. Rep. 85; Indianapolis Furnace & Mining Co. v. Herkimer, 46 Ind. 142; People v. Montecito Water Co., 97 Cal. 276, 32 Pac. 236, 33 Am. St. Rep. 172.

²⁸ In re Crown Bank, 44 Ch. Div. 634; Attorney General v. Lorman, 59 Mich. 157, 26 N. W. 311, 60 Am. Rep. 287; Riley v. Callahan Min. Co., 28 Idaho 525, 155 Pac. 665; Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co., 86 Tex. 143, 24 S. W. 16, 22 L. R. A. 802.

²⁹ Montgomery v. Forbes, 148 Mass. 249, 19 N. E. 342; Harris v. McGregor, 29 Cal. 125. See In re Mt. Sharon Cemetery, 277 Pa. St. 79, 120 Atl. 700.

³⁰ Hendrix v. Academy of Music, 73 Ga. 437; People v. Stockton &

Visalia R. Co., 45 Cal. 306, 13 Am. Rep. 178; Busenback v. Attica & Bethel Gravel Road Co., 43 Ind. 265.

³¹ Sweney v. Talcott, 85 Iowa 103, 52 N. W. 106; Park v. Zwart, 92 Iowa 37, 60 N. W. 220; Parsons v. Rinard Grain Co., 186 Iowa 1017, 173 N. W. 276; Douglass v. State Bank of Orlando, 77 Fla. 830, 82 So. 593.

³² Reed v. Richmond St. R. Co., 50 Ind. 342; People v. Selfridge, 52 Cal. 331.

³³ Moe v. Harris, 142 Minn. 442, 172 N. W. 494.

³⁴ Jersey City Gas Co. v. Dwight, 29 N. J. Eq. 246; Livesey v. Omaha Hotel Co., 5 Neb. 50; Holman v. State, 105 Ind. 569, 5 N. E. 702; Boyd v. Peach Bottom Ry. Co., 90 Pa. St. 169; Lake Ontario, A. & N. Y. R. Co. v. Mason, 16 N. Y. 451. See Eastern Products Corp. v. Tennessee Coal & Iron Co., 151 Tenn. 239, 269 S. W. 4, 40 A. L. R. 1483, 1511n.;

in.³⁵ Subscription and payment for a certain amount or percentage of the authorized capital are often made a condition precedent to the right to commence business.

The statutes generally provide for the issuance of a certificate of incorporation by some officer or court on the organization of a corporation, and the certificate is sometimes, though not always, made a condition precedent to corporate existence. The certificate must be obtained when required by the statute, and must be substantially in the form prescribed by the statute.³⁶ It is also generally required that the articles or memorandum of association, or the certificate of incorporation, shall be filed or recorded with the secretary of state or some other officer. In some jurisdictions this is a condition precedent to the legal existence of the corporation.³⁷ In others it is merely a condition precedent to the right of the corporation to engage in business.³⁸

Mandamus to compel officer to act.—In many states the Secretary of State or other official who is charged with the duty to determine whether the general incorporation law has been complied with in the organization of a corporation, and, if so, to issue an order or certificate of incorporation, or to permit a certificate to be filed, acts in a ministerial capacity only. If he has no discretion in the matter, a writ of *mandamus* will lie to compel him to act, and, in a proper case, to issue or file the articles or certificate.³⁹ On the other hand, in a few of the states there are statutes

Wechselberg v. Flour City Nat. Bank, 64 Fed. 90, 96, 26 L. R. A. 470; *In re Western Bank & Trust Co.*, 163 Fed. 713.

³⁵ *People v. Chambers*, 42 Cal. 201; *Floyd v. State ex rel. Baker*, 177 Ala. 169, 59 So. 280.

³⁶ *Stowe v. Flagg*, 72 Ill. 397; *Field v. Cooks*, 16 La. Ann. 153; *Callender v. Painesville & H. R. Co.*, 11 Ohio St. 516; *Parkside Cemetery Ass'n v. Cleveland, B. & G. L. Trac-tion Co.*, 93 Ohio St. 161, 112 N. E. 596, Ann. Cas. 1918 C 1051; *Wall v. Mines*, 130 Cal. 27, 62 Pac. 386; *Merges v. Altenbrand*, 45 Mont. 355, 123 Pac. 21; *Williams v. Everett*, — Mo. —, 200 S. W. 1045.

³⁷ *People ex rel. Tilton v. Mackey*, 255 Ill. 144, 99 N. E. 370; *Bigelow v. Gregory*, 73 Ill. 197; *Bergeron v. Hobbs*, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85; *Kaiser v. Lawrence Sav. Bank*, 56 Iowa 104, 8

N. W. 786, 41 Am. Rep. 85; *Guckert v. Hacke*, 159 Pa. St. 303, 28 Atl. 249; *Indianapolis Furnace & Mining Co. v. Herkimer*, 46 Ind. 142; *Capps v. Hastings Prospecting Co.*, 40 Neb. 470, 58 N. W. 956, 24 L. R. A. 259, 42 Am. St. Rep. 677. See note, 18 A. L. R. 376, effect on corporate existence of failure to file certificate in organizing a corporation.

³⁸ *Jhons v. People*, 25 Mich. 499; *Granby Mining & Smelting Co. v. Richards*, 95 Mo. 160, 8 S. W. 246; *Kaiser v. Lawrence Sav. Bank*, 56 Iowa 104, 8 N. W. 772, 41 Am. Rep. 85. See *Middle Branch Mut. Tel. Co. v. Jones*, 137 Iowa 396, 115 N. W. 3.

³⁹ *Franklin Bridge Co. v. Wood*, 14 Ga. 80; *Ex parte Burns*, 1 Tenn. Ch. 83; *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319; *State ex rel.*

which apparently confer upon the Secretary of State, or other officer or tribunal, discretionary powers in regard to the acceptance and approval of articles of incorporation, as to ascertain and determine not only that the articles are in proper form to meet the requirements of the statute, but that the object is not against public policy.⁴⁰

§ 16. Time of acquiring corporate existence.—A corporation comes into existence as such as soon as the charter is accepted in accordance with its terms, and not before such acceptance. For this purpose, a valid acceptance includes the performance of all conditions precedent prescribed by the statute.

It is important to determine the exact time at which a corporation comes into existence, for until then it cannot, in the nature of things, legally act as a corporation. "That a corporation," said the Illinois Supreme Court, "should have a full and complete organization and existence as an entity before it can enter into any kind of a contract or transact any business, would seem to be self-evident. . . . A corporation, until organized, has no being, franchise or faculties. Nor do those engaged in bringing it into being have any power to bind it by contract, unless so authorized by the charter. Until organized as authorized by the charter there is not a corporation, nor does it possess franchises or faculties for it or others to exercise, until it acquires a complete existence."⁴¹

Since, in the case of a private corporation, an acceptance of the charter, express or implied, is necessary, an association of persons to whom a charter is granted by special act of the legislature does not become a corporation until such acceptance. It does become a corporation, however, as soon as the charter is accepted, provided the acceptance is in substantial compliance with the terms of the charter, and the corporation may at once elect its officers and proceed to transact its business.⁴² The valid acceptance of a charter includes the performance of all conditions pre-

Security Savings & Loan Ass'n v. Brodigan, 44 Nev. 212, 192 Pac. 263. See McGalliard v. McCran, 97 N. J. Law 71, 116 Atl. 106. See Westlake Park Inv. Co. v. Jordan, 198 Cal. 609, 246 Pac. 807.

⁴⁰ Lloyd v. Ramsay, 192 Iowa 103, 183 N. W. 333.

⁴¹ Gent v. Manufacturers' & Merchants' Mut. Ins. Co., 107 Ill. 652. See also, Walton v. Oliver, 49 Kan.

107, 30 Pac. 172, 33 Am. St. Rep. 355; McVicker v. Cone, 21 Ore. 353, 28 Pac. 76. And see post, § 46.

⁴² Goshen & S. Turnpike Co. v. Sears, 7 Conn. 86; Hudson v. Carman, 41 Me. 84; Riddle v. Merrimack River Locks & Canals, 7 Mass. 169, 5 Am. Dec. 35; Randle v. Winona Coal Co., 206 Ala. 254, 89 So. 790, 19 A. L. R. 118.

cedent prescribed by the legislature. Therefore, when a corporation is organized under a general law, it does not come into existence until all the conditions precedent prescribed by the statutes are substantially complied with.⁴³ In some jurisdictions the corporation comes into existence as soon as the articles are filed or recorded, in others only upon filing proof of publication of the articles, and in a few only when the corporation organizes by the election of directors after stock is subscribed.⁴⁴

§ 17. The corporate name.—A name of some kind is essential to the existence of a corporation; but except in so far as there may be restrictions in the charter or in the general law, common or statute, it may adopt any name it may see fit, and it may have several names for different purposes. A corporation cannot change its name without legislative authority.

A corporate name is essential to the existence of a corporation, for without a name of some kind it could not enter into contracts, take, hold, and grant property, or sue and be sued.⁴⁵ A corporation may assume a name, just as a natural person may, for the purpose of entering into a contract or executing or receiving a conveyance, unless there is some express provision to the contrary in its charter or some other statute. If a note or deed is executed by a corporation under an assumed name, it is just as much bound as if it had used its proper name, and the same is true of any other contract. A contract entered into by or with a corporation under an assumed name may be enforced by either of the parties, if the identity of the corporation is established by the proof.⁴⁶

⁴³ *Parkside Cemetery Ass'n v. Cleveland, B. & G. L. Traction Co.*, 93 Ohio St. 161, 112 N. E. 596, Ann. Cas. 1918 C 1051; *Gent v. Manufacturers' & Merchants' Mut. Ins. Co.*, 107 Ill. 652; *Bergeron v. Hobbs*, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85; *Walton v. Oliver*, 49 Kan. 107, 30 Pac. 172, 33 Am. St. Rep. 355; *Wechselberg v. Flour City Nat. Bank*, 24 U. S. App. 308, 64 Fed. 90, 26 L. R. A. 470; *Montgomery v. Forbes*, 148 Mass. 249, 19 N. E. 342.

⁴⁴ When corporate existence begins. See *Sentinel Co. v. A. D. Meiselbach Motor Wagon Co.*, 144 Wis. 224, 128 N. W. 861, 32 L. R. A. (N. S.) 436, 140 Am. St. Rep. 1007; *State v. Insurance Co.*, 49 Ohio St.

440, 31 N. E. 658, 16 L. R. A. 611, 34 Am. St. Rep. 573; *W. L. Wells Co. v. Gastonia Cotton Mfg. Co.*, 198 U. S. 177, 185, 49 L. Ed. 1003, 25 Sup. Ct. 640; 14 C. J. 177, § 181.

⁴⁵ 1 Bl. Comm. 474, 475; *State ex rel. Great American Home Sav. Inst. v. Lee*, 288 Mo. 679, 233 S. W. 20; *Washington Fire Co. No. 7 of Wilmington v. Yates*, 13 Del. Ch. 32, 115 Atl. 365.

⁴⁶ *Melledge v. Boston Iron Co.*, 5 Cush. (Mass.) 158, 51 Am. Dec. 59; *Mount Palatine Academy v. Kleinschnitz*, 28 Ill. 133; *Marmet v. Archibald*, 37 W. Va. 778; *Ferry v. Cincinnati Underwriters*, 111 Mich. 261; *Woodrough & Hanchett Co. v. Witte*, 89 Wis. 537, 62 N. W. 518. Compare, however, *Cincinnati Cooperage Co.*

Effect of misnomer.—While a corporation must have a name in which to contract, to grant and receive property, and to sue and be sued, it does not follow that misnomer of a corporation in a contract, grant, will, or pleading will be fatal. On the contrary, it is well settled that, in the absence of statutory provision to the contrary, misnomer of a corporation is no more fatal than misnomer of an individual would be under the same circumstances. The general rule is that misnomer of a corporation will not invalidate a grant or conveyance to or by it,⁴⁷ or a contract with it,⁴⁸ or a devise or legacy to it,⁴⁹ if it appears from the instrument itself, or is shown by parol evidence, that it is the corporation intended.

Use of name of another corporation, or similar name.—At common law, and in some states under express statutory provision, a corporation cannot select a name which is the same as, or very similar to, that of another corporation created by or under the laws of the same state, for, like the right to use a trademark, a corporation has the exclusive right to the use of its corporate name. If corporators, therefore, select a name which has previously been adopted and is used by another corporation of the same state, an order or certificate of incorporation should be refused.⁵⁰ If necessary, a suit may be maintained to prevent incorporation under the same name as that of another corporation, or, if incorporation has

v. Bate, 96 Ky. 356, 26 S. W. 538, 49 Am. St. Rep. 300; Simpson v. Grand International Brotherhood of Locomotive Engineers, 83 W. Va. 355, 98 S. E. 580.

In a Michigan case, where two insurance companies, in issuing a policy, used a name to designate both of them, it was held that they might be sued under that name. *Ferry v. Cincinnati Underwriters*, 111 Mich. 261, 69 N. W. 483.

⁴⁷ *Northwestern Distilling Co. v. Brant*, 69 Ill. 658, 18 Am. Rep. 631; *Walrath v. Campbell*, 28 Mich. 111; *Douglas v. Branch Bank at Mobile*, 19 Ala. 659; *Hackett v. Marmet Co.*, 52 Fed. 268, 8 U. S. App. 149; *Chilton v. Brooks*, 71 Md. 445, 18 Atl. 868; *Woodrough & Hanchett Co. v. Witte*, 89 Wis. 537, 62 N. W. 518; *Chew v. First Presbyterian Church of Wilmington, Del., Inc.*, 237 Fed. 219.

⁴⁸ *Medway Cotton Manufactory*

v. Adams, 10 Mass. 360; *Culpepper Agricultural & Mfg. Society v. Digges*, 6 Rand. (Va.) 165, 18 Am. Dec. 708; *Berks & D. Turnpike Road v. Myers*, 6 Serg. & R. (Pa.) 12, 9 Am. Dec. 402; *Milford & C. Turnpike Co. v. Brush*, 10 Ohio 111, 36 Am. Dec. 78; *Chadsey v. McCreery*, 27 Ill. 253; *Chilton v. Brooks*, 71 Md. 445, 18 Atl. 868.

⁴⁹ In *re Kilvert's Trusts*, 7 Ch. App. 170; *First Parish in Sutton v. Cole*, 3 Pick. (Mass.) 232; *Minot v. Boston Asylum & Farm School for Indigent Boys*, 7 Mete. (Mass.) 416; *Vansant v. Roberts*, 3 Md. 119; *Ryan v. Martin*, 91 N. C. 464; *Washington & Lee University's Appeal*, 111 Pa. St. 572, 3 Atl. 664.

⁵⁰ *State v. McGrath*, 92 Mo. 355, 5 S. W. 29; *State ex rel. New Arlington Hotel Co. v. Hinkle*, 115 Wash. 298, 197 Pac. 4. See *State ex rel. Bellingham Pub. Co. v. Hinkle*, 120 Wash. 85, 206 Pac. 942.

already been effected, the use of the same name as that of another corporation will be enjoined at the suit of the latter, on the same principles upon which courts of equity enjoin the wrongful use of another's trademark.⁵¹

In *American Steel Foundries v. Robertson*,⁵² Mr. Justice Sutherland speaks of the exclusive right of a corporation to its name to preserve its identity and that of its business:

"Whether the name of a corporation is to be regarded as a trade-mark, a trade-name, or both, is not entirely clear under the decisions. To some extent the two terms overlap, but there is a difference, more or less definitely recognized, which is that, generally speaking, the former is applicable to the vendible commodity to which it is affixed, the latter to a business and its good will. See *Ball v. Broadway Bazaar*, 194 N. Y. 429, 434, 435, 87 N. E. 674. A corporate name seems to fall more appropriately into the latter class. But the precise difference is not often material, since the law affords protection against its appropriation in either view, upon the same fundamental principles. The effect of assuming a corporate name by a corporation under the law of its creation is to exclusively appropriate that name. It is an element of the corporation's existence." This principle applies where the name selected is so much like the name of another corporation as to mislead, although it may not be precisely the same.⁵³ But it does not apply, although there may be some similarity, if there is no fraud or fraudulent intent, and if it is not made to appear that injury has resulted or is likely to result.⁵⁴ A foreign corporation

⁵¹ *Tussaud v. Tussaud*, 44 Ch. Div. 678; *Newby v. Oregon Cent. Ry. Co.*, Fed. Cas. No. 10144, Deady, 609; *National Circle Daughters of Isabella v. National Order Daughters of Isabella*, 270 Fed. 723; *Chas. S. Higgins Co. v. Higgins Soap Co.*, 144 N. Y. 462, 39 N. E. 490, 27 L. R. A. 42, 43 Am. St. Rep. 769; *Holmes, Booth & Haydens Co. v. Holmes, Booth & Atwood Mfg. Co.*, 37 Conn. 278, 9 Am. Rep. 324; *Great Council v. Mohican Tribe*, 92 N. J. Eq. 593, 114 Atl. 440; *Armington v. Palmer*, 21 R. I. 109, 42 Atl. 308, 49 L. R. A. 95, 79 Am. St. Rep. 741; *Aiello v. Montecarlo*, 21 R. I. 496, 44 Atl. 931.

⁵² 269 U. S. 372, 46 Sup. Ct. 160.

⁵³ Thus, in a Missouri case it was held that a corporation could not adopt the name "Kansas City Real Estate Exchange," where there was

an existing corporation with the name "Kansas City Real Estate and Stock Exchange." *State v. McGrath*, 92 Mo. 355, 5 S. W. 29. And see *Chas. S. Higgins Co. v. Higgins Soap Co.*, 144 N. Y. 462, 39 N. E. 490, 27 L. R. A. 42, 43 Am. St. Rep. 769; *Lamb Knit-Goods Co. v. Lamb Glove & Mitten Co.*, 120 Mich. 159, 78 N. W. 1072, 44 L. R. A. 841.

⁵⁴ *Hygeia Water Ice Co. v. New York Hygeia Ice Co.*, 140 N. Y. 94, 35 N. E. 417, aff'g 65 Hun 619, 19 N. Y. Supp. 602; *Boston Rubber Shoe Co. v. Boston Rubber Co.*, 149 Mass. 436, 21 N. E. 875; *Elgin Butter Co. v. Elgin Creamery Co.*, 155 Ill. 127, 40 N. E. 616; *Nebraska Loan & Trust Co. v. Nine*, 27 Neb. 507, 43 N. W. 903, 20 Am. St. Rep. 686.

may sue in equity to restrain a domestic corporation from infringing its corporate name in any state in which it is lawfully carrying on business.⁵⁵

Change of name.—In the absence of express authority from the state, a corporation, although it may act in an assumed name, as heretofore explained, cannot abandon a name which has been given to it by the legislature in its creation, and adopt another as its proper name.⁵⁶ But the state may change its name with its consent, or may authorize it to do so.⁵⁷ The change, whether by the legislature or by the incorporators or stockholders under legislative authority, does not affect the identity of the corporation, or in any way affect the rights, privileges, or obligations previously acquired or incurred by it or its stockholders.⁵⁸

§ 18. Extension and revival of charters.—A charter which is about to expire, or which has expired, may be extended or revived by a special act of the legislature, or under general laws, in the absence of constitutional restrictions; and the effect is not to create a new and distinct corporation, but merely to continue the existence of the old corporation, unless a contrary intention appears.

The period for which corporations may exist is now very generally limited by the laws by or under which they are created or by provision in the articles; and by the weight of authority, after the expiration of the prescribed time, a corporation is dissolved, and ceases to exist for any purpose, unless some provision is made by the legislature for an extension of its charter.⁵⁹ Since corporations can be created by or under legislative authority only, it is only by or under such authority that the charter of a corporation can be

⁵⁵ General Film Co. of Missouri v. General Film Co. of Maine, 237 Fed. 64; Red Seal Refining Co. v. Red Seal Refining Corp., 115 Okla. 63, 241 Pac. 762.

⁵⁶ Reg. v. Registrar, 10 Q. B. 839; Shackleford v. Dangerfield, L. R. 3 C. P. 407; Sykes v. People, 132 Ill. 32, 23 N. E. 391; Cincinnati Cooperage Co. v. Bate, 96 Ky. 356, 26 S. W. 538, 49 Am. St. Rep. 300; American Elementary Elec. Co. v. Normandy, 46 App. Cas. (D. C.) 329, 339.

⁵⁷ In many jurisdictions there are provisions in general laws under which a corporation may change its

name under certain conditions, or upon complying with certain formalities. See Fletcher, Corporations, § 746.

⁵⁸ 1 Rolle, Abr. 513, 572; 4 Coke 87b; McCloskey v. Doherty, 97 Ky. 300, 30 S. W. 649; West v. Carolina Ins. Co., 31 Ark. 476; Hazelett v. Butler University, 84 Ind. 230; Ozan Lumber Co. v. Davis Sewing Mach. Co., 284 Fed. 161; German-American Mercantile Bank v. Foster, 116 Wash. 313, 199 Pac. 314; G. W. Raleigh Medical Co. v. Bunning, 104 Neb. 179, 176 N. W. 85.

⁵⁹ Boca Mill Co. v. Curry, 154 Cal. 326, 97 Pac. 1117. See post, § 24.

extended beyond the period for which it was created. The laws very often contain provisions under which stockholders and directors may take certain steps, and thereby extend the existence of the corporation for an additional period, and thus continue business without interruption or change.⁶⁰ Such an extension does not create a new corporation, in contemplation of the law, but merely continues the existence of the corporation under its original charter. It follows that it does not in any way affect the identity of the corporation, or its property or contract rights or liabilities.⁶¹

The power to create a corporation includes the power to revive a corporation, and the legislature therefore may revive and continue a charter which has expired, unless prevented by some constitutional prohibition. It has been held that the effect of such an act is, in contemplation of law, not to create a new corporation, but merely to revive and continue the old one, just as in a case where a charter is extended before its expiration.⁶²

⁶⁰ *Foster v. Essex Bank*, 16 Mass. 245, 8 Am. Dec. 135; *Cotton v. Mississippi & Rum River Boom Co.*, 22 Minn. 372; *Augusta & S. R. Co. v. City Council of Augusta*, 100 Ga. 701, 28 S. E. 126.

⁶¹ *Lincoln & Kennebec Bank v. Richardson*, 1 Me. 79, 10 Am. Dec. 34; *National Exch. Bank v. Gay*, 57 Conn. 224, 17 Atl. 555, 4 L. R. A. 343; *Town of Port Gibson v. Moore*, 13 Smedes & M. (Miss.) 157; *Frostburg Min. Co. v. Cumberland & P. R. Co.*, 81 Md. 28, 31 Atl. 698; *Ozan Lumber Co. v. Davis Sewing Mach. Co.*, 284 Fed. 161.

⁶² *Lincoln & Kennebec Bank v. Richardson*, 1 Me. 79, 10 Am. Dec. 34; *Town of Port Gibson v. Moore*, 13 Smedes & M. (Miss.) 157. Compare *Supreme Lodge, Knights of Pythias v. Weller*, 93 Va. 605, 25 S. E. 891; *Ozan Lumber Co. v. Davis Sewing Mach. Co.*, 284 Fed. 161.

Revival of a charter must be distinguished from reincorporation, the effect of which is to create a new and distinct corporation. See *Rossi v. Caire*, 186 Cal. 544, 199 Pac. 1042.

CHAPTER III.

DE FACTO CORPORATIONS AND CORPORATIONS BY ESTOPPEL; PROOF OF CORPORATE EXISTENCE.

§ 19. Corporations *de jure* and *de facto*.—A substantial failure to comply with the statutory conditions upon which corporate capacity may be acquired subjects the organization to direct attack by the state. But an honest effort to comply may give the organization which purports to do business as a corporation the status of *de facto* corporation which is not subject to collateral attack.

“Direct” versus “collateral” attack.—All the courts agree that in a direct proceeding by the state to question the right of an association to be a corporation, and to oust it from the exercise of corporate powers, it is necessary for the association to show that it is a corporation *de jure*; and to show this, it must show not only that there is a valid law under which it might be a corporation, and that there has been an attempt to organize as a corporation under the law, but also that all the requirements of the law intended as conditions precedent have been substantially complied with. It is not necessary, however, to show a *de jure* corporate existence, even as against the state, when the existence of a corporation is collaterally attacked, as in a suit against the state on a claim in favor of the corporation.

A corporation is a legal entity created by operation of statute upon the execution and filing of certain written instruments by the incorporators with certain public officers. When these instruments are executed, filed, and perhaps published, if required, the corporation comes into legal existence. But this can only be accomplished by a substantial compliance with the conditions precedent prescribed by statute. If a necessary prerequisite is omitted, a corporation *de jure* will not be created.¹ Thus, where a

¹ Wells Co. v. Gastonia Cotton Mfg. Co., 198 U. S. 177, 49 L. Ed. 1003, 25 Sup. Ct. 640; People ex rel. Weatherly v. Golden Gate Lodge, 128 Cal. 257, 60 Pac. 865; People v.

Montecito Water Co., 97 Cal. 276, 32 Pac. 236, 33 Am. St. Rep. 172; Martin v. Deetz, 102 Cal. 55, 62, 36 Pac. 368, 41 Am. St. Rep. 151. The filing of the articles of incorporation in

statute required articles of incorporation to be subscribed and acknowledged by five or more persons, and such articles, though subscribed by five persons, were acknowledged by four only, it was held that this was not a sufficient compliance with the statute, and that there was no legal incorporation as against a direct attack by the state.^{1a}

Corporations cannot be created like partnerships solely by the mutual agreement of the associates to do business as such. The legislature by general laws has laid down certain formalities of registration which must be observed. The privilege of doing business in a separate capacity, that is as a distinct entity, exempt from individual liability, is a franchise to be obtained under incorporation acts. The right to be considered as a corporation in general depends upon the substantial performance of the conditions specified in the statute. The consent of the state is absolutely necessary to the creation of any corporation, and must be expressly or impliedly given. But if there is a general consent to that kind of a corporation, and an honest effort to comply with the conditions upon which the consent is given, the organization may be treated by the courts as a corporation *de facto* even if the conditions are not exactly or even substantially complied with.

Let us take an imaginary case. A, B and C associate to engage as the X corporation in the motor truck business. They employ an attorney and attempt to comply with the provisions of the statute as to incorporation. By mistake of their attorney some item is omitted from the articles of incorporation or some required step such as the publication, or the filing of the articles in some office, is omitted. Supposing themselves to be a corporation they proceed to engage in the business through the directors and officers acting in the corporate name. One of their drivers, D, negligently injures E; and the supposed corporation becomes insolvent and is unable to pay its creditors. A, B and C are sued for the torts and the debts of the X company. Are they personally liable? Or suppose the X company was suing on a claim in contract or tort; could the defendant set up the irregularity in organization as a defense?

the office of the county clerk of the county in which the principal place of business is located may be made by statute an essential part of the process by which a corporation *de jure* is brought into existence. *Christian v. Bowman*, 49 Minn. 99, 51 N. W. 663. The technical omis-

sion to file affidavit of publication with Secretary of State is fatal to existence of corporation *de jure*.

^{1a} *People v. Montecito Water Co.*, 97 Cal. 276, 32 Pac. 236, 33 Am. St. Rep. 172. This decision seems unduly strict and technical.

By the doctrine of *de facto* corporations, A, B and C will be enabled to protect themselves from personal liability, and the X company will be able to sue as a corporation, without being subject to attack on its capacity for failure to comply with some of the statutory requirements. In a leading Minnesota case² eight persons signed, acknowledged and caused to be filed, articles assuming to form a corporation for the purpose of dealing in lands and leasing a building to carry out the general purposes of the Knights of Labor. The plaintiff furnished plumbing for the building and then sued the several subscribers to the stock as copartners doing business under the firm name of Knights of Labor Building Association. The theory was that the association having failed to become a corporation was in law a partnership and the members were liable as partners for its debts. The main ground of attack was that the place where the business was to be carried on was not distinctly stated in the articles, and they had other minor defects. It was held that a substantial compliance with the law is not necessary to constitute the association a *de facto* corporation. A *de facto* corporation exists where there is a law authorizing the creation of the corporation, and an attempt to organize a corporation pursuant to it and user as a corporation of the rights claimed to be conferred by the charter. The omission to state distinctly in the articles the place within which the business is to be carried on would not prevent the association becoming a corporation *de facto*. In spite of a material failure to comply with the statutory requirements, the attempt to comply may be sufficient to exclude personal liability.

The legislature has granted general permission to incorporate and sanctions self-incorporation under general laws according to certain more or less important formalities. The corporate privilege is granted to those who comply. There are various degrees of noncompliance. The statutes do not prescribe what shall be the consequences of defective compliance or that anyone may volunteer to attack the corporate existence whether the question of non-

² Finnegan v. Noerenberg, 52 Minn. 239, 53 N. W. 1150, 18 L. R. A. 778, 38 Am. St. Rep. 552. Johnson v. Corser, 34 Minn. 355, 25 N. W. 799, in which it was held that what had been done was ineffectual to limit the individual liability of the associates, is distinguished on the ground that they had not gone

far enough. They had merely signed articles but had not attempted to give them publicity by filing them for record. This case would perhaps not now be followed. (See 1 Machen, Corporations, ch. 4; 20 Harv. L. Rev. 466, 21 Harv. L. Rev. 305, 25 Harv. L. Rev. 623, 13 Michigan L. Rev. 271.)

compliance concerns his rights and interests or not.^{2a} The recognition of *de facto* corporate existence when the conditions precedent to incorporation have not been substantially complied with is founded on public policy and practical convenience.^{2b} It is essential to the safety of business transactions with corporations. It would endanger the rights of corporations and of those dealing with them if questions could be raised as to irregularities in incorporation, in cases in which such questions have no just bearing on the transaction involved.

§ 20. Proof of corporate existence.

If an issue as to corporate existence is properly raised by the pleadings, it must be proved by the party asserting it by evidence showing either the creation of a corporation *de jure* or a corporation *de facto*, or an admission or estoppel to deny corporate existence. Dealings on a corporate basis may raise an estoppel or amount to an admission of corporate capacity. In some states the necessity of proving corporate existence is dispensed with unless the adverse party specifically denies it by a verified answer. But in other states a general denial will put in issue the corporate existence of the plaintiff, where it is alleged in the complaint to be a corporation. In an action by or against a corporation the corporate character of either party should be alleged, and if its existence or capacity as such is properly put in issue, it must be proved. Statutes very commonly make the certificate of the Secretary of State *prima facie* proof of corporate existence. The same effect may be given to a certified copy of the articles of association. In general existence is regularly proved by showing at least a substantial compliance with the requirements of the statute. Some courts hold that the best evidence rule applies, which is satisfied by the production of the incorporation papers of the corporation or a duly

^{2a} See *Union Trust & Savings Bank of Ames v. Blair-Harper Seed Co.*, 200 Iowa 374, 202 N. W. 839. The peculiar Iowa Statute imposes personal liability on stockholders for failure substantially to comply with requirements of statute as to incorporation. *Adler v. Baker-Dodge Theatre Co.*, 190 Iowa 970, 181 N. W. 254; *Parsons v. Rinard Grain Co.*, 186 Iowa 1017, 173 N. W. 276; *Graham v. Sewell*, 80 Fla. 720, 86 So. 639; *Brinkley Car Works & Mfg.*

Co. v. Curfman, 136 Iowa 476, 114 N. W. 12; *Ragland v. Doolittle*, 100 Miss. 498, 56 So. 445; *Hessig-Ellis Drug Co. v. Wilkerson*, 115 Miss. 668, 76 So. 570.

^{2b} Basis of *de facto* doctrine: 13 Mich. Law Rev. 290; 19 Columbia Law Rev. 391; 20 Harv. Law Rev. 456, 469; 25 Harv. Law Rev. 623; 11 Illinois Law Rev. 1, 13; 16 id. 51; *Machen, Corporations*, § 291; *Morawetz Corporations*, §§ 652, 744.

authenticated copy, and showing the proper filing, recording or publication as required by statute.³

Corporate existence *de jure* may be proved by producing the articles or certificate of incorporation properly executed, and proof of their filing and substantial compliance with the other statutory requirements if any such as publication.⁴ Corporate existence *de facto* may be proved by parol evidence of a *bona fide* attempt to comply with the statutory requisites, even though not amounting to substantial compliance, together with evidence of user or the actual exercise of corporate powers, such as the keeping of an office, and the doing of business in the corporate name through a board of directors.⁵

In some states, direct testimony by a witness that a company is a corporation is held to be merely the opinion or conclusion of the witness. So in a New Jersey case the question was asked: "Is the Vogue Silk Co. a corporation?" The purpose was to prove the incorporation of the plaintiff, the defendant having denied this in its answer. The court held that this was not a proper method of proof.⁶ So testimony of certain defendants that they went to East St. Louis with a lawyer and there complied with laws of the state and got a charter, was held to be a mere conclusion of law,

³ Sumter Tobacco Warehouse Co. v. Phoenix Assur. Co., 76 S. C. 76, 56 S. E. 654, 10 L. R. A. (N. S.) 736, 121 Am. St. Rep. 941, 11 Ann. Cas. 780. See Wall v. Mines, 130 Cal. 27, 62 Pac. 386; Mokelumne Hill Canal & Mining Co. v. Woodbury, 14 Cal. 424, 73 Am. Dec. 658.

By statute the mere fact of doing business under a corporate name may be made *prima facie* evidence of incorporation. Imperial Curtain Co. v. Jacob, 163 Mich. 72, 127 N. W. 772.

So a certificate of due incorporation by the secretary of state may be made *prima facie* proof. Chronos Land Co. v. Crichton, 150 La. 963, 91 So. 408. So certificate of Comptroller of the Currency authorizing national bank to do business. Farmers' Nat. Bank v. Johnston, 71 Okla. 172, 176 Pac. 236.

⁴ In Harris v. McGregor, 29 Cal. 124, it was held where a certificate of incorporation was offered in evidence to prove the title to plaintiff's ditch to be in a certain cor-

poration that it did not itself establish the existence of a corporation because it was fatally defective in failing to state the name of the city or town and county where the place of business was to be located, as required by statute. There must be a substantial compliance with all the forms of the act by persons seeking to become a body corporate, before a corporation *de jure* is created. With other evidence it might show a *de facto* corporation.

⁵ Brown v. Webb, 60 Ore. 526, 120 Pac. 387, Ann. Cas. 1914 A 148. Parol evidence is admissible to show *de facto* corporate existence by an attempt to organize a corporation by execution of articles of incorporation, and doing business in a corporate capacity without producing the corporate records or accounting for their loss. Johnson v. Okerstrom, 70 Minn. 303, 308, 73 N. W. 147.

⁶ Maagget v. A. Brawer Silk Co., 95 N. J. Law 72, 111 Atl. 656. See American Ins. Co. v. McClelland, 184 Ill. App. 381.

having no probative force. They should have produced the incorporation papers duly authenticated with proof of filing and recording.⁷ In an Arkansas case plaintiff, a corporation organized and doing business in the state of New York, sued the defendant in Arkansas for goods sold and delivered. The answer denied the plaintiff's corporate existence. At the trial, the court, over the defendant's objection, permitted the plaintiff's manager to testify that the plaintiff was a corporation organized under the laws of New York, and doing business in that state. It was held that such evidence was admissible and sufficient to establish the plaintiff's existence as a *de facto* corporation and its capacity to maintain the suit.⁸ In criminal prosecutions, where the existence of a corporation is in issue, it may be proved according to some cases by evidence of general reputation.⁹

§ 21. Organization for an unauthorized purpose or under unconstitutional statute.—If a corporation is organized for an unauthorized purpose, it may be ousted in proceedings by the state, and its existence may be collaterally attacked by individuals, unless they are estopped.

If it is attempted to organize a corporation for a purpose which is not within the purview of the statute under which the attempt is made, the state may certainly institute *quo warranto* proceedings and oust the association from the exercise of corporate powers.¹⁰ In

⁷ *People v. Clarence Struble*, 275 Ill. 162, 113 N. E. 938; *Owen v. Shepard*, 59 Fed. 746.

⁸ Proof of existence by direct evidence. *Kelley v. Stern Publishing & Novelty Co.*, 147 Ark. 383, 227 S. W. 609; *Pacific Drug Co. v. Hamilton*, 71 Wash. 469, 128 Pac. 1069; *Farmers' Nat. Bank v. Johnston*, 71 Okla. 172, 176 Pac. 236. See *Goldberg, Bowen & Co. v. Dimick*, 169 Cal. 187, 146 Pac. 672 (reinforced by fact that notes in suit were payable to "G. B. & Co., Inc.")

⁹ In criminal cases of offenses against corporate property corporate existence has been allowed to be proved by general reputation of being a corporation, as question is merely an incidental one. *Turner v. State*, 109 Ark. 332, 158 S. W. 1072; *Dick v. State*, 107 Md. 11, 68 Atl. 286, 576. Testimony by one of company's agents that it is a corpora-

tion. *State v. Rogeboom*, 145 Iowa 620, 124 N. W. 783, 29 L. R. A. (N. S.) 37; *People v. Morley*, 8 Cal. App. 372, 97 Pac. 84.

¹⁰ *State v. Critchett*, 37 Minn. 13, 32 N. W. 787; *State v. Debenture Guarantee & Loan Co.*, 51 La. Ann. 1874, 26 So. 600; *Attorney General v. Lorman*, 59 Mich. 157, 26 N. W. 311, 60 Am. Rep. 237. And see post, §§ 260, 261.

It has been held that where a corporation attempted to organize under some law, even if the law under which it proceeded was not good, it may avail itself of the existence of the general law at least so far as to be regarded as a *de facto* corporation, because it has done practically what the general law required, though not actually following it or professing to do so. *McTigue v. Macon Const. Co.*, 94 Ga. 306, 21 S. E. 701, 32 L. R. A. 208,

order that there may be a *de facto* corporation, there must be a consent by the state to such an organization, and therefore there must be some authority of law under which, except for defects and irregularities, there might be a *de jure* corporation.¹¹ Corporate capacity is open to collateral attack on the ground that no law provides for such a corporation, unless the other party is estopped to raise the question. A corporation by estoppel is not dependent on statutory authorization. In a case that arose in South Dakota, there was an attempt to organize a banking corporation at a time when the statutes did not authorize incorporation for this purpose. Later the statute was amended authorizing it. The bank continued to do business and held itself out as duly incorporated. It was held that the bank was a *de facto* corporation and that its stockholders and officers were not individually liable as members of a partnership to its depositors who had dealt with the bank as a corporation.¹²

To restrain the unauthorized assumption of corporate privileges, it is regarded as necessary to require something more than mere user to give *de facto* corporate existence. There must be some recognition of the state as the source of corporate privilege. The consent of the state in the form of a law under which such a corporation might be lawfully organized is therefore usually laid down as one of the essentials, and also a *bona fide* attempt to organize under the statute. This amounts to a submission to the state's authority. It has been said that there is no corporation *de facto*, "(1) where the associates organize under a law which is unconstitutional; (2) where they organize under a law which permits the formation of some corporations, but not such a corporation as the associates assume to form; (3) where their incorporation failed because of their lack of good faith; (4) where the legal incorporation of the associates has ceased, owing to the lapse of time; and (5) where their assumption of the corporate privilege

47 Am. St. Rep. 153; 11 Columbia Law Rev. 160; Jennings v. Dark, 175 Ind. 332, 92 N. E. 778.

¹¹ Davis v. Stevens, 104 Fed. 235; Tulare Irr. Dist. v. Shepard, 185 U. S. 1, 46 L. Ed. 773, 22 Sup. Ct. 531; People ex rel. v. New York Cent. R. Co., 283 Ill. 334, 119 N. E. 299; Brandenstein v. Hoke, 101 Cal. 131, 35 Pac. 562; Evenson v. Ellingson, 67 Wis. 634, 31 N. W. 342. See also, Georgia Southern & F. R. Co. v.

Mercantile Trust & Deposit Co., 94 Ga. 306, 315, 21 S. E. 701, 32 L. R. A. 208, 47 Am. St. Rep. 153; Taylor v. Branham, 35 Fla. 297, 17 So. 552, 39 L. R. A. 362, 48 Am. St. Rep. 249; Eaton v. Walker, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102.

¹² Mason v. Stevens, 16 S. D. 320, 92 N. W. 424. See note 16 Harv. Law Rev. 362. Compare Davis v. Stevens, 104 Fed. 235.

is naked." ^{12a} Some of these propositions, however, as we shall see, are open to serious question.

Most of the courts hold that there cannot be a corporation *de facto* under a statute which is unconstitutional, for an unconstitutional statute is absolutely void.¹³ The fundamental principle is that the state controls the formation of corporations by statute. If the state has not authorized or consented to the formation of such a corporation, it is a different case than where the state has authorized it upon certain conditions and formalities and the associates have attempted to comply but have fallen into some irregularity in their proceedings. If the consent of the state has been given by some law which is unconstitutional on some merely technical ground, it might be regarded as evidence of the policy of the state to permit such corporations. But the prevailing view appears to be that an unconstitutional law is the same in effect as no law at all, even if associates organize in good faith in reliance upon it. The only protection would be found in the doctrine of corporations by estoppel referred to later. By the better view there may arise an estoppel to deny corporate existence by dealings on a corporate basis, even though the statute under which it purports to exist is unconstitutional.^{13a}

§ 22. Basis of doctrine against collateral attack on *de facto* corporations.—If an association assuming to act as a corporation has been so far organized as to be a *de facto* corporation, the general rule is that its existence as a corporation cannot be collaterally attacked.

The basis of the doctrine is to be found in public policy and practical convenience in the security of business transactions and

^{12a} Warren, Collateral Attack on Incorporation, 21 Harv. Law Rev. 305, 314. Compare Carpenter, *De Facto Corporations*, 25 Harv. Law Rev. 623.

¹³ Brandenstein v. Hoke, 101 Cal. 131, 35 Pac. 562; Georgia S. & F. R. Co. v. Mercantile Trust & Deposit Co., 94 Ga. 306, 21 S. E. 701, 32 L. R. A. 208, 47 Am. St. Rep. 153; Green v. Graves, 1 Doug. (Mich.) 351; Skinner v. Wilhelm, 63 Mich. 568, 30 N. W. 311; Eaton v. Walker, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102. Contra, City of St. Louis v. Shields, 62 Mo. 247; Catholic Church at Lexington v. Tobbein, 82

Mo. 418; Coxe v. State, 144 N. Y. 396, 39 N. E. 400; Building & Loan Ass'n v. Chamberlain, 4 S. D. 271, 56 N. W. 897 (estoppel). See Jennings v. Dark, 175 Ind. 332, 92 N. E. 778; Clark v. American Cannel Coal Co., 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217. Lewinsohn, Liability to third persons of associates in defectively incorporated associations, 13 Mich. Law Rev. 271; 14 C. J. 216, 1 Fletcher, Corporations, secs. 279, 288, 294; 11 Columbia Law Rev. 160, 13 Harv. Law Rev. 690.

^{13a} Building & Loan Ass'n v. Chamberlain, 4 S. D. 271, 56 N. W. 897; 13 Michigan Law Rev. 271.

in elimination of quibbles over technicalities which are of no concern to those dealing with the corporation.

Although failure to comply with the mandatory requirements of the statute in organizing a corporation will prevent the formation of a corporation *de jure*,—that is, a corporation which will have a legal existence and right to exercise corporate powers as against a direct proceeding by the state to question its corporate existence,—it does not necessarily prevent the formation of a *de facto* corporation, or a corporation which will have a valid existence as against others than the state. When the state brings *quo warranto* proceedings against an association to question its right to exercise corporate powers, the association must show that all conditions precedent prescribed by the statute under which it was organized were substantially complied with, as this is necessary to the existence of a corporation *de jure*. But as a general rule, when the corporate existence of an association is collaterally attacked, either by an individual or by the state, it is only necessary for it to show that it is a corporation *de facto*.¹⁴ It has been said by the Ohio court that “it is just as important and just as necessary that corporations organized under Ohio laws should proceed in the manner required by statute, in matters of form as well as substance, as it is that persons executing a last will and testament should conform in matters of both form and substance to the statutory provisions pertaining thereto.”¹⁵ This is however hardly the point of view of the courts in working out the doctrine of corporations *de facto*.

It may be asked: How may a court recognize an association as being a corporation *de facto*, when those formalities have not been complied with which the legislature has laid down as conditions precedent to obtaining the corporate franchise? Is this judicial legislation? The answer is that the courts exercise their common sense and intelligence in giving effect to the purpose rather than to the letter of the law. The third person dealing with the corporation will rarely be prejudiced if the company is recognized as a

¹⁴ *Society Perun v. City of Cleveland*, 43 Ohio St. 481, 3 N. E. 357; *Snider's Sons' Co. v. Troy*, 91 Ala. 224, 8 So. 754, 11 L. R. A. 619, 24 Am. St. Rep. 887; *Finnegan v. Noerenberg*, 52 Minn. 239, 53 N. W. 1139, 18 L. R. A. 644; *Stout v. Zulick*, 48 N. J. Law 599, 7 Atl. 362; *Lamming*

v. Galusha, 81 Hun 247, 30 N. Y. Supp. 767, *aff'd* 151 N. Y. 648, 45 N. E. 1132; *Cochran v. Arnold*, 58 Pa. St. 399.

¹⁵ *State ex rel. Stuart v. Urschel*, 104 Ohio St. 172, 135 N. E. 630, 633, *per Marshall*, C. J.

corporation in spite of slips or irregularities in its formation. It would rarely be just to allow a wrongdoer to quibble over such a collateral question to escape liability for his wrongdoing toward the company. It would be equally unjust to allow a claimant against the company to assert the individual liability of the associates when this is different from what he bargained for. Business transactions should not be upset on the ground of technical and immaterial flaws in the rather formal steps of incorporation proceedings.¹⁶

The *de facto* doctrine recognizes that in general, legislative sanction is essential to the acquisition of corporate powers and privileges. But it refuses to allow parties to attack the corporate capacity of those doing business as a corporation where they are not concerned in the failure to comply with all of the statutory requirements and formalities of organization. This saves the parties and the courts from wasting time in collateral inquiries which are not relevant to the merits of the cases before the court. The doctrine simplifies proof and eliminates technical quibbles.¹⁷ The law might indeed go to the extent of saying that in private litigation the question of irregularities and defects in the organization of an association claiming to be a corporation and doing business as such could not be raised, except where such defect operated to the prejudice of the party making the objection.¹⁸ Except in rare cases such defects would be immaterial as to the merits of the case.

¹⁶ *Kardo Co. v. Adams*, 231 Fed. 950, 966. A strict insistence on all the statutory formalities for recognition of corporate capacity would in many cases result in gross injustice. The courts have found a way to give effect to the statute and do justice between the parties by denying to a party to the suit the right to raise the question of corporate capacity when that is not involved in the merits of the case, as where a wrongdoer seeks to escape the consequences of his wrongdoing on the ground of the failure of a corporation to comply with every detail of the law under which it was organized, a question with which he has no concern.

¹⁷ The *de facto* doctrine is not founded on any principle of estoppel, but upon broader principles of policy and business convenience.

Public policy demands the recognition of corporate capacity where there has been an attempt at incorporation, in spite of technical flaws. *East Norway Lake Church v. Froislie*, 37 Minn. 447, 35 N. W. 260; *Swofford Bros. Dry Goods Co. v. Owen*, 37 Okla. 616, 133 Pac. 193, L. R. A. 1916C 189, 196; *Society Perun v. City of Cleveland*, 43 Ohio St. 481, 3 N. E. 357.

¹⁸ Persons who have dealt with a pretended corporation should not lose their recourse against the individual members without being assured of that substituted security, if any, which compliance with the incorporation laws as to subscription and payment of capital stock would give them. But a person may well be confined to relief against the association as a corporation where he suffers no loss or prejudice by reason

§ 23. Essentials of a *de facto* corporate existence.

There has been much conflict in the decisions of the different courts with respect to what is sufficient to give an association the status of a *de facto* corporation. Some, while requiring an attempt to organize, have held that there need not be even a colorable compliance with conditions precedent prescribed by the legislature; and others have held that all conditions precedent must be substantially complied with. The doctrine generally laid down is to the effect that an association is a corporation *de facto*, when, and only when, there is—

(1) A special act or general law under which a corporation with the powers assumed by the association in question might exist.

(2) A *bona fide* attempt to organize as a corporation under such charter or law and comply with the statutory formalities.

(3) The exercise or user of corporate powers.

In other words: "Where it is shown that there is a charter or a law under which a corporation with the powers assumed might lawfully be incorporated, and there is a colorable compliance with the requirements of the charter or law, and a user of the rights claimed under the charter or law, the existence of a corporation *de facto* is established."¹⁹

of the defects or irregularities of incorporation. 2 Morawetz, Corporations sec. 652, 744; 8 Minn. Law Rev. 414, 415.

In a few states penal statutes impose individual liability upon stockholders of an association assuming to act as a corporation without compliance with the law, or do business before a certain per cent of capital stock is subscribed and paid. Charles v. Young, 74 Fla. 298, 76 So. 869; Winfield v. Truitt, 71 Fla. 38, 70 So. 775; Clegg v. Hamilton & Wright Co., 61 Iowa 121, 15 N. W. 865; Heuer v. Carmichael, 82 Iowa 288, 47 N. W. 1034 (no estoppel); Ragland v. Doolittle, 100 Miss. 498, 56 So. 445.

In California, § 358, Civil Code, provides: "The due incorporation of any company claiming in good faith to be a corporation under this part, and doing business as such, or its right to exercise corporate powers, shall not be inquired into col-

laterally in any private suit to which such *de facto* corporation may be a party; but such inquiry may be had at the suit of the state on information of the attorney general." After ten years of doing business in good faith, no such inquiry can be made even by the state; it becomes a corporation *de jure* by prescription. See also Iowa & Ky. Statutes.

¹⁹ Tulare Irr. Dist. v. Shepard, 185 U. S. 1, 46 L. Ed. 773, 22 Sup. Ct. 531; Kardo Co. v. Adams, 231 Fed. 950; Stout v. Zulick, 48 N. J. Law 599, 7 Atl. 362; Eaton v. Walker, 76 Mich. 579, 43 N. W. 638; 6 L. R. A. 102; East Norway Lake Church v. Froislie, 37 Minn. 447, 35 N. W. 260; Finnegan v. Noerenberg, 52 Minn. 239, 53 N. W. 1150, 18 L. R. A. 644, 38 Am. St. Rep. 552; Society Perun v. City of Cleveland, 43 Ohio St. 481, 3 N. E. 357; Montgomery v. Forbes, 148 Mass. 249, 19 N. E. 342; In re Gibb's Estate, 157 Pa. St. 59, 27 Atl. 383, 22 L. R. A. 276.

Elements of estoppel not necessary.—In some of the cases, the doctrine in relation to *de facto* corporations has been confused with the doctrine, to be presently explained, in relation to estoppel to deny corporate existence, and it seems to have been assumed that the existence of a *de facto* corporation may be collaterally questioned by an individual, unless he has dealt with the association as a corporation, and thereby estopped himself to deny its corporate character.²⁰ It is contended by some writers that the *de facto* doctrine should not be invoked for the benefit of the associates themselves against persons who have not recognized or contracted with them as a corporation, as where a person is injured by some employee of the company and is referred to an empty treasury for compensation. This, however, is clearly erroneous. The doctrine in relation to *de facto* corporations is based upon the ground that it would be contrary to public policy to permit a collateral attack upon the corporate existence of a body of men assuming to act as a corporation under a valid law, and after a colorable or apparent organization under the law, and does not require the existence of any element of estoppel. The fact that a person has not estopped himself by dealing with a corporation *de facto* does not entitle him to collaterally attack its existence as a corporation, for a corporation *de facto* has an *actual* existence, and is a corporation in contemplation of the law, as against every person except the state, and even as against the state except in a direct proceeding to question its corporate existence.²¹

Sufficiency of compliance with the requirements of the statute.—There is much conflict in the decisions as to what compliance with the requirements of the statute in the organization of a corporation is necessary to the creation of a corporation *de facto*. In

²⁰ See *Bates v. Wilson*, 14 Colo. 140, 158, 24 Pac. 99; *Heaston v. Cincinnati & Ft. W. R. Co.*, 16 Ind. 275, 79 Am. Dec. 430; *Butchers' & Drovers' Bank of St. Louis v. McDonald*, 130 Mass. 264. See 20 *Harvard Law Rev.* 456, 472, 474; 35 *Harvard Law Rev.* 198.

²¹ "The theory that a *de facto* corporation has no real existence, that it is a mere phantom, to be invoked only by that rule of estoppel which forbids a party who has dealt with a pretended corporation to

deny its corporate existence, has no foundation, either in reason or authority. A *de facto* corporation is a reality. It has an actual and substantial legal existence. It is, as the term implies, a corporation." *Society Perun v. City of Cleveland*, 43 Ohio St. 481, 490, 3 N. E. 357. See also, *East Norway Lake Church v. Froislie*, 37 Minn. 447, 35 N. W. 260; *Kardo Co. v. Adams*, 231 Fed. 950, 968; *Westlake Park Inv. Co. v. Jordan*, 198 Cal. 609, 246 Pac. 807.

some states it has been held that if a general law authorizing the formation of corporations requires certain steps to be taken, and expressly or impliedly makes compliance with such requirements a condition precedent to the existence of corporate powers, failure to comply *substantially* with any one of such conditions precedent will prevent the coming into existence of a corporation either *de jure* or *de facto*, and that the omission may be taken advantage of collaterally as well as directly, and in any action or proceeding in which the question of incorporation may be properly in issue,²² unless there is some element of estoppel. This view, however,—that there cannot be a corporation *de facto* without a *substantial* compliance with all conditions precedent,—cannot be sustained on principle, and is opposed to the decided weight of authority. A substantial compliance with all conditions precedent will make a corporation *de jure*.²³

The true doctrine, amply supported by authority, is to the effect that there is a corporation *de facto* when there has been a *bona fide* attempt to organize under the law, and a *colorable or apparent* compliance with the requirements of the law. As was said in a Minnesota case, “the failure as to some substantial requirement will prevent the body being a corporation *de jure*; but, if there be user pursuant to such attempted organization, it will not prevent it being a corporation *de facto*.”²⁴

If there has been a colorable or apparent compliance with the provisions of the statute, the fact that the requirements which have not been substantially complied with were intended by the legislature as conditions precedent to the exercise of corporate powers will not prevent the existence of a corporation *de facto*.²⁵

²² National Shutter Bar Co. v. G. F. S. Zimmerman & Co., 110 Md. 313, 78 Atl. 19; Bonaparte v. Baltimore, H. & L. R. R. Co., 75 Md. 340, 23 Atl. 784; Boyce v. Trustees of Townsontown Station of M. E. Church, 46 Md. 359; Shields v. Clifton Hill Land Co., 94 Tenn. 123, 28 S. W. 668, 26 L. R. A. 509, 45 Am. St. Rep. 700; Bergeron v. Hobbs, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85.

²³ A question of *de facto* corporation arises only when the defect in organization amounts to a failure to comply substantially with some mandatory provision or condition precedent imposed by the incorporation statute. See ante, § 15.

²⁴ Finnegan v. Noerenberg, 52 Minn. 239, 244, 53 N. W. 1150, 18 L. R. A. 778, 38 Am. St. Rep. 552. See also, Stout v. Zulick, 48 N. J. Law 599, 7 Atl. 362; Inter-Ocean Newspaper Co. v. Robertson, 296 Ill. 92, 129 N. E. 523; Evens v. Anderson, 132 Minn. 59, 155 N. W. 1040 (municipal corporation school district); Tulare Irr. Dist. v. Shepard, 185 U. S. 1, 13, 46 L. Ed. 773, 22 Sup. Ct. 531; Northern Pac. R. Co. v. John Day Irr. Dist., 106 Ore. 140, 211 Pac. 781 (irrigation district, *de facto* municipal corporation.)

²⁵ Duggan v. Colorado Mortg. & Inv. Co., 11 Colo. 113, 17 Pac. 105; Canfield v. Gregory, 66 Conn. 9, 33 Atl. 536; Bushnell v. Consolidated

There must be an apparent attempt to comply with the statute as to creation of corporations. But how far must it go? What acts are sufficient to constitute a corporation *de facto*? When there has been a failure to perform some act or condition precedent to incorporation, upon what principle are courts justified in holding that there is a corporation created good except against the state? These questions are still unsettled and cannot be definitely answered.^{25a}

Necessity for bona fide attempt to organize.—The naked assumption of a corporate name will not suffice to give an association the status of a *de facto* corporation. "Neither the hope, the belief, nor the statement by the parties that they are incorporated, nor the signing of articles of incorporation which are not filed, where filing is requisite to create the corporation, nor the user of the pretended franchise of such nonexistent corporation, will constitute such a corporation *de facto* as will exempt those who actively and knowingly use its name to incur obligations from their individual liability to pay them."²⁶ Substantial compliance is not necessary, but it is not enough to show merely that there is a statute under which they might have become incorporated, and that they have agreed among themselves to act, and have acted, as a corporation. In addition to this, there must have been a *bona fide* attempt to organize as a corporation under the statute. Thus where persons contributed money for the erection of a mill

Ice Machine Co., 138 Ill. 67, 27 N. E. 596; Eaton v. Walker, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; Finnegan v. Noerenberg 52 Minn. 239, 53 N. W. 1150, 18 L. R. A. 644, 38 Am. St. Rep. 552; Lamming v. Galusha, 81 Hun (N. Y.) 247, 30 N. Y. Supp. 767, aff'd 151 N. Y. 648, 45 N. E. 1132; Eaton v. Aspinwall, 19 N. Y. 119; Society Perun v. City of Cleveland, 43 Ohio St. 481, 3 N. E. 357.

^{25a} It has been suggested that the limits of the *de facto* doctrine should be set by those safeguards which are needed against the abuse of immunity from individual liability. Carpenter, 8 Minn. Law Rev. 409, 414, 3 Oregon Law Rev. 213; Morawetz, §§ 652, 744, 748. It would seem, however, that the requirement of a *bona fide* attempt to comply with statutory conditions in-

volves also a question of submission to the authority of the state, a recognition that corporate capacity cannot in general be assumed in defiance of legislative requirements.

²⁶ Doyle-Kidd Dry Goods Co. v. A. W. Kennedy & Co., 154 Ark. 573, 243 S. W. 66; Harrill v. Davis, 168 Fed. 187, 22 L. R. A. (N. S.) 1153; In re Ballard, 279 Fed. 574, 596; Ogden Packing & Provision Co. v. Wyatt, 59 Utah 481, 204 Pac. 978; Baker v. Bates-Street Shirt Co., 6 Fed. (2d) 854. Mere user alone of a name importing a corporation is not sufficient to constitute a *de facto* corporation where there is no colorable compliance with some of the essential statutory requirements, such as recording the certificate in the registry of deeds and filing a copy thereof with the secretary of state and paying the filing fee.

intending to form a corporation, and prepared articles to be filed in the office of the Secretary of State, which were returned for irregularities, it was held that there was no *de facto* corporation, although business was conducted under the name selected for the corporation.²⁷

If A is prejudiced in relying upon the representation of the associates that they have incorporated, by reason of their non-compliance with statutory conditions, then the courts should disregard the separate corporate entity or capacity and permit A to hold the associates individually liable. Thus if no stock has been subscribed or the requirements of the law relating to providing a corporate capital as a substitute for individual liability have been neglected, fairness between the parties might permit attack upon the status of the corporation. If statements in the certificate of incorporation respecting capital subscribed and paid in are false, and the corporation was a straw corporation, set up without capital and without assets to defraud creditors, the associates should be held to individual liability.²⁸ In an Alabama case²⁹ evidence was offered to show that nothing was paid for the shares of the pretended corporation's pretended capital stock, that the affidavits of subscriptions made and paid were knowingly false and fraudulent, that no money or property of value was ever paid or transferred to the company to constitute its capital, and all this was in furtherance of an intention to carry on a partnership under guise of a corporation in such a way that the company would have no assets to meet its liabilities and that the individuals could not be held liable for debts contracted in the name of the company. It was held that this and similar evidence was competent to show that the parties did not in good faith attempt to create a corporation, but that it was a fraudulent device. If associates in bad faith organize a defective corporation it will be disregarded as separate entity just as a *de jure* corporation would be disre-

²⁷ In re Ballard, 279 Fed. 574, 596. The mere adoption of a "constitution and by-laws" which contain no declaration of intent to form a corporation, not signed, acknowledged or filed is not a sufficient effort at compliance with the incorporation statute. *H. J. Hughes Co. v. Farmers' Union Produce Co.*, 110 Neb. 736, 194 N. W. 872; *Rainwater v. Childress*, 121 Ark. 541, 182 S. W. 280.

²⁸ On effect of failure to subscribe more than nominal capital upon the power of the corporation to enforce executory contracts, see *Eastern Products Corporations v. Tennessee Coal, Iron & R. Co.*, 151 Tenn. 239, 269 S. W. 4, 40 A. L. R. 1483.

²⁹ *Christian & Craft Grocery Co. v. Fruitdale Lumber Co.*, 121 Ala. 340, 25 So. 566; 21 *Harv. Law Rev.* 323, 324, 325.

garded if used as a cloak for fraud. Incorporators cannot take unjust advantage of their failure to comply with the statute. The *de facto* doctrine is devised to promote fair dealing.³⁰ But if the statutes of the state or of some other state are substantially complied with, corporate existence cannot in general be collaterally challenged, even though false statements were made in the incorporation papers or fraud was practiced on the Secretary of State in procuring a certificate of incorporation.³¹

In a federal case arising under the Ohio statutes,³² three corporations, each owning motor patents, undertook to form a new corporation to hold and handle their several patents. Five clerks in the employ of a law firm signed and filed articles of incorporation, and also subscribed for one share of stock each, and one as trustee subscribed for enough more to make up the required ten per cent. The incorporators paid nothing and had no beneficial interest in the stock or in the corporation which was formed. The federal district court in a suit for infringement of patent, held that such procedure did not create a lawfully organized corporation. The court went partly on the ground that the Kardo Company was a dummy and the directors were dummies. Therefore a court of equity could look through the form of things to their substance and declare the corporation "nonexistent" on its own motion. This decision was overruled in *Kardo Co. v. Adams*.³³ There is no requirement in the law that the incorporators of an Ohio corporation must have any financial interest of any kind in the corporation. They are usually regarded as mere instruments for purposes of preliminary organization. The corporate ex-

³⁰ *Heisen v. Churchill*, 205 Fed. 368. Articles not filed; defendant could not set up a pretended corporate liability in defense of his personal liability, when by his own neglect corporation has no *de facto* existence and is without substance or assets, location or organization. Estoppel was not discussed.

³¹ It is generally held that the legal existence of a corporation cannot be attacked collaterally on the ground that it was fraudulently incorporated. *Foster v. Hip Lung Ying Kee & Co.*, 243 Ill. 163, 90 N. E. 375; *Boatman's Bank v. Gillespie*, 209 Mo. 217, 108 S. W. 74; *United States Vinegar Co. v. Schlegel*, 143 N. Y. 537, 38 N. E. 729. But

see *Montgomery v. Forbes*, 148 Mass. 249, 19 N. E. 342. Where defendant did not in good faith attempt to organize the corporation and made false statements as to the principal place of business intended, the incorporator is personally liable for goods purchased in the name of the corporation. The case is to be explained probably on the ground of disregarding the entity for fraud rather than on the ground of failure to form a corporation *de jure* or *de facto*.

³² *American Ball Bearing Co. v. Adams*, 222 Fed. 967, *rev'd* 231 Fed. 950.

³³ 231 Fed. 950, 964.

istence is not invalid because of the dummy character of the incorporators. The filing of the articles followed by the transaction of corporate business created a corporation at least *de facto*.

There is a conflict of authority as to whether a corporation *de facto* may be recognized, notwithstanding the failure to file the required incorporation in the proper public office. Some cases hold that such failure to file is not a fatal shortcoming.³⁴ It is of course a stronger case if the paper is filed in one of two required places. Other cases adopt the theory that corporate existence is not attained unless the attempt to comply with the statute includes the filing of the articles or certificate in the office of the Secretary of State or elsewhere as prescribed, especially where stockholders are seeking to avoid individual liability as partners.³⁵

In a New Jersey case³⁶ the plaintiff A was injured in a collision between two auto busses operated by associates B and C who later

³⁴ Nonfiling—not fatal. *Bakersfield Town Hall Ass'n v. Chester*, 55 Cal. 98; *Galvin v. Detroit Steering Wheel & Windshield Co.*, 176 Mich. 569, 142 N. W. 742; *Frawley v. Tenafly Transp. Co.*, 95 N. J. Law 405, 113 Atl. 242, 22 A. L. R. 369, 376. Note on effect upon the corporate existence of failure to file certificate in organizing a corporation. See *United States v. Delatour*, 275 Fed. 137 (county clerk's office only); *Tisch Auto Supply Co. v. Nelson*, 222 Mich. 196, 200, 192 N. W. 600, 602 (failure to file articles by inadvertence of attorney; parties did business in corporate name.)

³⁵ According to some authorities, failure to file or record incorporation papers will prevent *de facto* recognition, and the associates will be individually liable, unless by estoppel the creditor is precluded from claiming against them. *Garnett v. Richardson*, 35 Ark. 144; *Morse v. Burkhart Mfg. Co.*, 154 Ark. 362, 242 S. W. 810; *Richardson v. Pitts*, 71 Mo. 128; *Tonge v. Item Pub. Co.*, 244 Pa. 417, 91 Atl. 229; *Bigelow v. Gregory*, 73 Ill. 197; *Harrill v. Davis*, 168 Fed. 187, 22 L. R. A. (N. S.) 1153; *Ogden Packing & Provision Co. v. Wyatt*, 59 Utah 481, 204 Pac. 978, 22 A. L. R. 359, 367; 21 Harv. Law Rev. 325; *Baker v. Bates-Street Shirt Co.*, 6 Fed.

(2d) 854. Mere user of a name importing a corporation is not sufficient. There must be a colorable compliance with some of the essential statutory requirements, such as recording the certificate in the registry of deeds and filing a copy with the secretary of state, and paying the filing fee. See also, *H. J. Hughes Co. v. Farmers' Union Produce Co.*, 110 Neb. 736, 194 N. W. 872, 37 A. L. R. 1314. See note, 22 A. L. R. 376, 379; *New York Nat. Exch. Bank v. Crowell*, 177 Pa. St. 313, 35 Atl. 613. Failure to record the certificate of incorporation as required by the act in the county where the chief operations are to be carried on will render the incorporators personally liable to persons who deal with the association without knowledge of the incorporation. The business name may not give notice of this.

³⁶ *Frawley v. Tenafly Transp. Co.*, 95 N. J. Law 405, 113 Atl. 242, 22 A. L. R. 369. See 35 Harv. Law Rev. 203, 198: "Between the commission of the tort and the bringing of suit, the *de facto* corporation has become *de jure*. . . . It imposes a pre-natal obligation upon the corporation and is analogous to allowing recovery against it for the tort of its promoters, which is clearly not permitted."

completed incorporation as the defendant corporation. The busses had been purchased in the corporate name two days before the accident. At the same time a certificate of incorporation had been drawn up and signed. By statute the corporate existence began upon the filing of the certificate in the office of the Secretary of State, after recording it with the county clerk. The certificate was recorded the day after the accident and filed four days later. The corporation was held liable for the tort of an agent of the associates before they had completed their proceedings under the incorporation statute. This decision went on the ground that the jury was justified in finding that the company was, at the time of the accident, already a corporation *de facto*. There may be a corporation *de facto* before the filing of the certificate. If in addition to signing the certificate the incorporators did some corporate acts in attempted execution of the powers conferred by the certificate they may be treated as though they were incorporated.

Necessity for assumption or user of corporate powers.—To make a body of men a corporation *de facto*, it is not enough to show merely that there is a law under which they might be a corporation, that they have attempted in good faith to organize under it, and that they have colorably or apparently complied with its provisions, but it is also necessary to show that they have assumed the character of a corporation, and exercised corporate powers.³⁷ The basis and reason of this requirement are not entirely self-evident and in recent cases it is held that slight evidence of corporate action will suffice. Taking subscriptions to and issuing stock, electing managers and directors, adopting by-laws, buying a lot, and constructing and leasing a building upon it, are a sufficient user to constitute a corporation *de facto*.³⁸

§ 24. Continuing as corporation after expiration of charter.

It has been held by some courts that where a corporation continues to carry on its corporate business in its corporate name after its legal existence has ended by the expiration of the authorized period of its duration, that it may be treated as a cor-

³⁷ *Martin v. Deetz*, 102 Cal. 55, 36 Pac. 368, 41 Am. St. Rep. 151; *Bash v. Culver Gold Min. Co.*, 7 Wash. 122; *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Tulare Irr. Dist. v. Shepard*, 185 U. S. 1, 46 L. Ed. 773, 22 Sup. Ct. 531.

³⁸ *Finnegan v. Noerenberg*, 52 Minn. 239, 53 N. W. 1150, 18 L. R. A. 778, 38 Am. St. Rep. 552. Slight evidence of corporate acts will suffice. *Brown v. Webb*, 60 Ore. 526, 120 Pac. 387, Ann. Cas. 1914A 148 (transacting business as a corporation.)

poration *de facto*, and may sue and be sued as a corporation.³⁹ This seems the desirable rule, except in those cases where the statute forbids a longer term of existence. But some courts hold otherwise even though the limit is merely in the articles.⁴⁰

In *Wilson v. Brown*,⁴¹ the certificate of incorporation of a manufacturing company provided that the term of its existence should be 20 years. The period of corporate existence expired. The business was, however, continued, stockholders' meetings were held and the directors continued to transact the business as a corporation, and in the corporate name. In view of the fact that the general law permitted corporations to exist for 50 years, *de facto* existence was recognized. But termination by forfeiture or by legislative provision is different from the mere expiration of the agreed period.⁴²

§ 25. Effect of ouster by the state.

Since a corporation *de facto* is a reality, and has an actual and substantial legal existence, subject only to the right of the state to oust it from the exercise of corporate powers in a direct proceeding brought for that purpose, it follows that a judgment of ouster in such a proceeding does not relate back so as to affect the validity of transfers or other acts done or contracts made by it before its corporate existence was questioned. As to such acts, the rules in relation to *de facto* corporations apply notwithstanding the judgment of ouster.⁴³

A conveyance by a corporation *de facto* is not affected by a subsequent judgment of ouster against the corporation at the suit of the state. In an Ohio case,⁴⁴ a corporation "Perun" gave a purchase money mortgage to C which was not recorded by C.

³⁹ *Wilson v. Brown*, 107 N. Y. Misc. 167, 175 N. Y. Supp. 688; *Arlington Hotel Co. v. Rector*, 124 Ark. 90, 186 S. W. 622; *Miller v. Newburg Orrel Coal Co.*, 31 W. Va. 836, 8 S. E. 600, 13 Am. St. Rep. 903.

⁴⁰ *Bradley v. Reppell*, 133 Mo. 545, 32 S. W. 841, 54 Am. St. Rep. 685 (statutory limit); *Meramec Spring Park Co. v. Gibson*, 268 Mo. 394, 188 S. W. 179 (statutory limit); *Bonfils v. Hayes*, 70 Colo. 336, 201 Pac. 677. See *Held v. Crosthwaite*, 260 Fed. 613, 627, per *Rogers, J.*, dissenting.

⁴¹ 107 N. Y. Misc. 167, 173, 175 N. Y. Supp. 688.

⁴² *Van Landingham v. United Tuna Packers*, 189 Cal. 353, 208 Pac. 973; *Newhall v. Western Zinc Min. Co.*, 164 Cal. 380, 128 Pac. 1040.

⁴³ *Society Perun v. City of Cleveland*, 43 Ohio St. 481, 3 N. E. 357; *American Salt Co. v. Heidenheimer*, 80 Tex. 344, 15 S. W. 1038, 36 Am. St. Rep. 743; *McPhee v. Reclamation Dist. No. 765*, 161 Cal. 566, 119 Pac. 1077 (ouster does not invalidate prior assessments by a *de facto* corporation).

⁴⁴ *Society Perun v. City of Cleveland*, 43 Ohio St. 481, 3 N. E. 357.

Subsequently Perun conveyed to B, a *de facto* corporation. B conveyed the premises so acquired to various parties prior to the recording of C's mortgage. In a *quo warranto* proceeding B was ousted of all rights and franchise to be a corporation. C brought suit to foreclose its mortgage against the grantees, mortgagees and purchasers from B and claimed that the conveyance to B was void as against C. A judgment for C in the trial court was reversed on the ground that a corporation *de facto* may acquire and convey the title to real estate. The rights acquired or conveyed will not be defeated by subsequent ouster in *quo warranto* on the ground of some defect in the incorporation. The doctrine of a corporation *de facto* is not based on estoppel by having engaged in transactions with the supposed corporation, but upon public policy. "A *de facto* corporation is a reality. It has actually substantial legal existence. It is, as the term implies, a corporation." Acts done by the corporation *de facto* will thus be given the same legal consequences as if done by a *de jure* corporation.

§ 26. Rights and liabilities of *de facto* corporations.

It is sufficient to show a *de facto* corporate existence in almost all actions or proceedings in which the existence of a body of men as a corporation may be in issue, except in a direct proceeding by the state in *quo warranto* to question their *right* to be a corporation, and to oust them from the exercise of corporate powers. "A corporation *de facto* may legally do and perform every act and thing which the same entity could do or perform were it a *de jure* corporation. As to all the world except the paramount authority under which it acts and from which it receives its charter, it occupies the same position as though in all respects valid, and even as against the state, except in direct proceedings to arrest its usurpation of power, * * * its acts are to be treated as efficacious." ⁴⁵

A *de facto* corporation is not merely a corporation "in fact," but also in law. Its corporate capacity arises from the fact of its attempted corporate organization. The general rule is that its existence or capacity as a corporation cannot be collaterally attacked or questioned either by individuals or by the state. Its right to exist as a corporation as affected by irregularities and defects

⁴⁵ *People v. La Rue*, 67 Cal. 526, 530, 8 Pac. 84. A corporation *de facto* can do and perform every act which the same entity could do were

it a *de jure* corporation. Even as against the state, except in direct proceedings, its acts are to be treated as efficacious.

in the incorporation procedure can only be reached in *quo warranto* proceedings brought by the state to forfeit its charter.⁴⁶

A *de facto* corporation has the same capacity as a *de jure* corporation to enter into contracts, and it is sufficient, therefore, to show a *de facto* corporate existence in order to sustain an action by or against an association as a corporation on a note, bond, or other contract,⁴⁷ or in order to defeat an action against the stockholders or members of an association as individuals on a note or other contract made by them as a corporation,⁴⁸ or an action against the officers making such a contract.⁴⁹ We shall also see that, as a general rule, a person who contracts with an association as a corporation is estopped in most jurisdictions to deny its incorporation for the purpose of holding the associates individually liable.⁵⁰ And it is sufficient to show a *de facto* corporate existence when the validity of a contract by a body of men claiming to be a corporation is in issue in a suit between third persons.⁵¹

It is also well settled that a corporation *de facto* is just as capable of taking and holding property, real or personal, as a corporation *de jure*, and is just as capable of conveying or transferring property. A conveyance or transfer of property to or by a corporation *de facto*, therefore, is valid and binding as

⁴⁶ *D. R. Wilder Mfg. Co. v. Corn Products Refining Co.*, 236 U. S. 165, 59 L. Ed. 520, 35 Sup. Ct. 398, Ann. Cas. 1916 A 118; *Root v. Wear*, 98 Kan. 234, 157 Pac. 1181; *McCann v. Children's Home Society of California*, 176 Cal. 359, 168 Pac. 355.

⁴⁷ *In re Halsey W. Kelley & Co.*, 215 Fed. 155; *Georgia Southern & F. R. Co. v. Mercantile Trust & Deposit Co.*, 94 Ga. 306, 21 S. E. 701, 32 L. R. A. 208, 47 Am. St. Rep. 153; *Heaston v. Cincinnati & Ft. W. R. Co.*, 16 Ind. 275, 79 Am. Dec. 430; *Buffalo & A. R. Co. v. Cary*, 26 N. Y. 75.

⁴⁸ *Humphreys v. Mooney*, 5 Colo. 282; *Stout v. Zulick*, 48 N. J. Law, 599, 7 Atl. 362; *Inter-Ocean Newspaper Co. v. Robertson*, 296 Ill. 92, 98, 129 N. E. 523; *Cochran v. Arnold*, 58 Pa. St. 399; *In re Gibb's Estate*, 157 Pa. St. 59, 27 Atl. 383, 22 L. R. A. 276. Compare, however, *Kaiser v. Lawrence Sav. Bank*, 56 Iowa 104, 8 N. W. 772, 41 Am. Rep. 85.

It is by no means always practicable for purchasers of stock to examine every step taken in the

organization of the corporation. To hold the officers and stockholders individually liable as co-partners for its debts because the corporation had not fully and substantially complied with all formalities would be contrary to reason and justice. 16 Ill. Law Rev. 51.

⁴⁹ *Bartholomew v. Bentley*, 1 Ohio St. 37; *Lamming v. Galusha*, 81 Hun (N. Y.) 247, 30 N. Y. Supp. 767, aff'd 151 N. Y. 648, 45 N. E. 1132; *Held v. Crosthwaite*, 260 Fed. 613.

⁵⁰ *Bushnell v. Consolidated Ice Mach. Co.*, 138 Ill. 67, 27 N. E. 596, post, § 28.

Parties who deal with a corporation as such, that is on a corporate basis, should not be allowed to claim more than they bargained for, and hold stockholders personally liable, even if it falls short of being a *de facto* corporation. *Gartside Coal Co. v. Maxwell*, 22 Fed. 197.

⁵¹ *New Haven Wire Co. Cases* (*Baring v. Galpin*), 57 Conn. 352, 394, 18 Atl. 266, 5 L. R. A. 300; *Smith v. Mayfield*, 163 Ill. 447, 457, 45 N. E. 157.

against all the world except the state, and even as against the state except in direct proceedings in *quo warranto* to inquire into the right to exercise corporate franchises.⁵² A mortgage made by or to a corporation *de facto* is as valid as if it were made by or to a corporation *de jure*, and cannot be attacked on the ground of want of incorporation, either by the mortgagor or by persons claiming under him or it, or by third persons.⁵³

A *de facto* corporation is as fully liable in an action for damages for wrongs committed by it as a corporation *de jure* would be, and therefore it is only necessary to show a *de facto* corporate existence to sustain an action against a corporation for negligence causing personal injury or death, or injury to property, or for trespass, or conversion, or infringement of a patent, trade mark, or copyright.⁵⁴ It has been held that the members of an association claiming to be a corporation must show full compliance with the statutory requirements, or, in other words, a *de jure* corporate existence, when they seek to defeat an action against them as individuals for wrongful acts (keeping a vicious animal), on the ground that such acts were corporate acts.⁵⁵ This view, however, cannot be sustained to the extent of holding members of a *de facto* corporation liable in tort for acts of officers merely because of their being members, and where they do not actually participate in or authorize the wrong. The rule must be the same as when it is sought to hold the members of a *de facto* corporation liable on contracts made by the corporation. Of course, officers and members of a *de facto* corporation who participate in wrongful acts by the corporation are personally liable, as well as the corporation, but this is true also in the case of a *de jure* corporation.

Subscriptions to capital stock.—The doctrine that a corporation *de facto* has the same capacity to contract and to enforce its

⁵² United States v. Delatour, 275 Fed. 137; Doyle v. San Diego Land & Town Co., 46 Fed. 709; Baltimore & P. R. Co. v. Fifth Baptist Church, 137 U. S. 568, 34 L. Ed. 784, 11 Sup. Ct. 185; Finch v. Ullman, 105 Mo. 255, 16 S. W. 863, 24 Am. St. Rep. 383; East Norway Lake Church v. Froislie, 37 Minn. 447, 35 N. W. 260; Society Perun v. City of Cleveland, 43 Ohio St. 481, 3 N. E. 357.

⁵³ Georgia Southern & F. R. Co. v. Mercantile Trust & Deposit Co., 94 Ga. 303, 21 S. E. 701, 32 L. R. A. 208, 47 Am. St. Rep. 153.

⁵⁴ Persse & Brooks Paper-Works v. Willett, 19 Abb. Pr. (N. Y.) 416; Pinkerton v. Pennsylvania Traction Co., 193 Pa. St. 229, 44 Atl. 284.

⁵⁵ Vredenburg v. Behan, 33 La. Ann. 635; Slocum v. Head, 105 Wis. 431, 434, 81 N. W. 673, 50 L. R. A. 324; Warren 20 Harv. Law Rev. 456, 474. Compare Lamming v. Galusha, 81 Hun (N. Y.) 247, 30 N. Y. Supp. 767, aff'd 151 N. Y. 648, 45 N. E. 1132. See 35 Harv. Law Rev. 198, 203, note, tort liability of a *de facto* corporation.

contracts as a corporation *de jure* applies to the subscriptions to the capital stock of a corporation after its organization and assumption of corporate powers. If a person subscribes for stock in a corporation after it is organized, it is sufficient to show *de facto* corporate existence, to support an action on the subscription.⁵⁶ It is otherwise, however in the case of subscriptions prior to incorporation. In such a case, it is a condition precedent to any liability on the subscription that the corporation shall be legally organized, and a *de jure* corporate existence is necessary before an action can be maintained on the subscription, unless waiver or estoppel can be shown.⁵⁷ This is not a case of refusal to apply the *de facto* doctrine or recognize the legal existence of the corporation, but of the construction of the contract of subscription as being an agreement to take shares in a corporation to be regularly incorporated.

Right to exercise power of eminent domain.—According to the better opinion, the rule that *de facto* corporate existence is sufficient as against every person but the state is as applicable in proceedings by a corporation to take land under the power of eminent domain as in the cases above mentioned, and it is not necessary in such proceedings that it shall show that it is a *de jure* corporation.⁵⁸ Some courts, however, have taken a contrary view, and have held that in order to take land for public use against the will of the owner a *de jure* corporate existence must be shown.⁵⁹ This, however, is not a refusal to recognize the *de*

⁵⁶ *Heaston v. Cincinnati & Ft. W. R. Co.*, 16 Ind. 275, 79 Am. Dec. 430; *Eaton v. Aspinwall*, 19 N. Y. 119; *Buffalo & A. R. Co. v. Cary*, 26 N. Y. 75; *Hamilton v. Clarion, M. & P. R. Co.*, 144 Pa. St. 34, 23 Atl. 53, 13 L. R. A. 779. And see post, § 36.

⁵⁷ *Capps v. Hastings Prospecting Co.*, 40 Neb. 470, 58 N. W. 956, 24 L. R. A. 259, 42 Am. St. Rep. 677; *Indianapolis Furnace & Mining Co. v. Herkimer*, 46 Ind. 142. And see post, § 36. See also, *C. E. Carpenter*, 25 Harv. Law Rev. 638.

⁵⁸ *Vallejo & N. R. Co. v. Reed Orchard Co.*, 169 Cal. 545, 147 Pac. 238; *Central of Georgia R. Co. v. Union Springs & N. R. Co.*, 144 Ala. 639, 39 So. 473, 2 L. R. A. (N. S.) 144; *Detroit & T. S. L. R. Co. v. Campbell*, 140 Mich. 384, 394, 103

N. W. 862; *Postal Cable Co. v. Oregon S. L. R. Co.*, 23 Utah 474, 482, 65 Pac. 735, 90 Am. St. Rep. 705; *Wellington & P. R. Co. v. Cashie & C. Railroad & Lumber Co.*, 114 N. C. 690, 19 S. E. 646; *McAuley v. Columbus, C. & I. C. Ry. Co.*, 83 Ill. 348; *Thomas v. St. Louis, B. & S. Ry. Co.*, 164 Ill. 634, 45 N. E. 405; *Morrison v. Forman*, 177 Ill. 427, 53 N. E. 73; *Niemeyer & Darragh v. Little Rock Junction Railway*, 43 Ark. 111.

⁵⁹ *Atlantic & O. R. Co. v. Sullivant*, 5 Ohio St. 276; *Powers v. Hazelton & L. Ry. Co.*, 33 Ohio St. 429; *Orrick School Dist. v. Dorton*, 125 Mo. 439, 28 S. W. 765; *In re Brooklyn, W. & N. R. Co.*, 72 N. Y. 245; *Tulare Irr. Dist. v. Shepard*, 185 U. S. 1, 46 L. Ed. 773, 22 Sup. Ct. 531; *In re New York*,

facto corporation, but a construction of the statutes conferring the power to condemn lands. These may be strictly interpreted as being intended by the legislature to apply only to corporations regularly formed as contracted with more or less self-constituted corporations which have a more precarious right to exist. There is also a conflict of opinion as to whether it is sufficient to show a *de facto* corporate existence when a corporation seeks, under statutory authority, to collect assessments or taxes against property for benefits resulting from the construction of its works, as in the case of incorporated drainage and reclamation districts or companies, turnpike companies, and the like.⁶⁰

§ 27. Corporations by estoppel.

- (1) An association which purports to be a corporation and enters into a contract or transaction as such cannot escape liability when sued as a corporation on the ground of defects in its organization, even though not a corporation *de facto*.
- (2) When such an association sues as a corporation one who has contracted with it on a corporate basis cannot deny its corporate existence in an action on such contract.
- (3) There is a conflict of authority as to whether one who contracts or deals with such an association as a corporation has the right to sue the officers or members individually as partners or otherwise, on the ground that exemption from individual liability can only be obtained when the association acquires the status of a corporation *de jure* or *de facto*.

Persons may assume to act as a corporation when they have not gone far enough in their attempt to incorporate to acquire even a *de facto* corporate standing. Under certain circumstances either the association or the person contracting with them as a corporation may be "estopped" to deny that they are a corporation.

W. & B. R. Co., 193 N. Y. 72, 85 N. E. 1014; Queen City Tel. Co. v. City of Cincinnati, 73 Ohio St. 64, 76 N. E. 392; Hampton v. Clinton Water & Water Supply Co., 65 N. J. Law 158, 46 Atl. 650.

A *de facto* corporation has no power to exercise eminent domain. Rogers v. Toccoa Power Co., 161 Ga. 524, 131 S. E. 517, 44 A. L. R. 534, 542 (note on condemnation by *de*

facto corporation). See 20 C. J. 913; 7 R. C. L. 68, 69; 20 Harvard Law Rev. 456 (collateral attack).

⁶⁰ Knight v. Flatrock & W. Turnpike Co., 45 Ind. 134; Busenback v. Attica & Bethel Gravel Road Co., 43 Ind. 265; Osborn v. People, 103 Ill. 224; Evans v. Lewis, 121 Ill. 478, 13 N. E. 246; McPhee v. Reclamation Dist. No. 765, 161 Cal. 566, 119 Pac. 1077.

This is ordinarily expressed in terms of estoppel although various other principles are involved. The doctrine of "corporation by estoppel" does not involve a recognition that an irregular corporation has acquired the corporate status generally. It only considers the legal consequences of a particular transaction done in the corporate name by associates assuming to be corporation and dealt with as such by the other party. The *de facto* doctrine on the other hand, by excluding collateral attack for various irregularities on grounds of public policy and more convenient remedies, in effect recognizes the acquisition of a corporate status. The doctrine of "estoppel" requires a reasonable consideration of the equities of the case, and whether irregularity of incorporation should be open to inquiry on grounds of fairness between the parties. Just as in the case of a *de facto* corporation procedural convenience, the avoidance of immaterial inquiry into the details of incorporation formalities, and fairness to all parties concerned favor treating the association actually purporting to be a corporation and doing business on that basis, as though it were incorporated.

It is necessary to classify the different situations in which the doctrine of corporations by estoppel is invoked. Decisions in one class of cases may not be authority in another class. We may distinguish:

1. Cases in which the alleged corporation or one of its members is seeking to escape liability by setting up a defect in the organization.

2. Cases in which a defendant is seeking to escape liability to a corporation plaintiff by setting up irregularities in its organization.

3. Cases in which the question is whether irregularities in the organization will subject the associates to individual or partnership liability.⁶¹

Suppose that A, B and C call themselves a corporation X and do business in the corporate name without making any attempt to comply with the statute regulating the obtaining of a corporate existence or franchise. P contracts with the company as a corpora-

⁶¹ 7 Minn. Law Rev. 42. See *Brown v. Atlanta Railway & Power Co.*, 113 Ga. 462, 39 S. E. 71. Corporations by estoppel are not based upon the same principle as corporations *de facto*. Estoppel may

prevail when there is no color of incorporation, or where the law under which the corporation claims to exist is unconstitutional. See 37 A. L. R. 1314; 20 Harv. Law Rev. 458.

tion. In an action for breach of contract P sues A, B and C as joint promisors under full personal liability. They defend on the ground that P is estopped to question their status as a corporation, and that they contracted as a corporation and not as individuals. P contends that the defendants have no right to the corporate privilege of limited liability.

The question of individual liability, as an alternative to suit against the association as a corporation is a question of substantive right. Limitation of liability is a privilege which is normally an incident of incorporation, and the associates have not satisfied the conditions *de jure* nor *de facto*. But a limitation of liability may perhaps be found by reason of an implied term of any contract made on a corporate basis, and also by reason of the limitations on the authority of the agents of the company. The theories on which associates in an irregular association may seek to escape the unlimited liability of principals for debts and contracts incurred in the corporate name are: (1) that signing articles and making an attempt at incorporation have given the organization a corporate status as a *de facto* corporation; (2) that the plaintiff is *estopped* to assert individual liability against them by recognizing them as a corporation *pro hac vice* even if it is not a corporation *de facto*; (3) that by contracting with them as a corporation he has impliedly agreed not to assert individual liability; (4) that the agents of the association had no authority actual or ostensible to bind stockholders as partners or principals.

The so-called estoppel that arises to deny corporate capacity does not depend on the presence of the technical elements of equitable estoppel, viz., misrepresentations and change of position in reliance thereon, but on the nature of the relations contemplated, that one who has recognized the organization as a corporation in business dealings should not be allowed to quibble or raise immaterial issues on matters which do not concern him in the slightest degree or affect his substantial rights.⁶²

⁶² Lowell-Woodward Hardware Co. v. Woods, 104 Kan. 729, 180 Pac. 734.

The difference between giving a name to a conclusion and giving a reason for it is not always observed. To name a would-be corporation a *de facto* corporation, for example, does not explain it, nor to say that a party is "estopped" to deny its corporate existence does not show

the reason or policy or principle of the doctrine. The use of the term "estoppel" has been very misleading to the courts in this connection.

The ordinary estoppel arises where A makes a false representation of fact and B is induced to change his position in reliance on the representation. A will then be precluded from setting up claims or defenses which are inconsistent with the

Estoppel by holding out pretended corporation.—As a general rule, one who participates in holding out an association as a corporate body, and thereby induces persons to deal with it as such, is estopped to deny his representation to their prejudice. Such an estoppel may arise against the promoters, members, or stockholders of a pretended corporation, against the directors or other officers, or against the pretended corporation itself, or the members collectively.

A person who has participated in promoting, or who has become a stockholder or member of, a pretended corporation, and thus participated in holding it out to the world as a corporation, is estopped to deny its corporate existence as against its creditors for the purpose of escaping statutory liability for its debts;⁶³ or as a defense to an action for damages for neglect of his duties as director.^{63a}

The doctrine in relation to estoppel to deny corporate existence operates, not only as against persons dealing with a corporation or pretended corporation, and as against members and officers individually, but also as against the members collectively, or, in other words, against the pretended corporation itself. If a body of men assume to act as a corporation, and enter into a contract as such, they cannot deny their legal existence as a corporation in an action against them, as such, on the contract. It is only in this class of cases that the elements of a true estoppel appear to be present. If A contracts with an association which pretends to be a corporation he may sue the associates as a corporation and

representation. The corporation by estoppel doctrine may be explained as being in part a rule of procedure, as to the right to sue or be sued in a common name; in part a rule of property, that title may be acquired and conveyed in a common name; in part a rule of contract, that the substantial rights of parties will be limited to what they bargained for; in part a rule of agency that the associates gave no authority to the officers to bind them personally. See 43 Am. Law Reg. (N. S.) 409, 504, 576.

In *Snider's Sons' Co. v. Troy*, 91 Ala. 224, 8 So. 658, 11 L. R. A. 515, 24 Am. St. Rep. 887, "the court takes in succession all the positions which it is possible to take in favor

of the immunity of the defendants. In the earlier part of the opinion the collateral attack doctrine is relied upon. Then the court works out an estoppel. Next there is the suggestion of a contract," and finally the court speaks of corporation *de facto*. *Pepper*, 43 Am. Law Reg. (N. S.) 423. See also, *Stout v. Zulick*, 48 N. J. L. 599, 7 Atl. 362. ⁶³ *Casey v. Galli*, 94 U. S. 673, 24 L. Ed. 168, 307; *Canfield v. Gregory*, 66 Conn. 9, 33 Atl. 536; *Slocum v. Providence Steam & Gas Pipe Co.*, 10 R. I. 112; *Slocum v. Warren*, 10 R. I. 116; *McCarthy v. Lavasche*, 89 Ill. 270, 31 Am. Rep. 83.

^{63a} *Council v. Brown*, 151 Ga. 564, 107 S. E. 867.

the principle of estoppel will prevent them from setting up the falsity of their representation as a defense.⁶⁴

It is frequently said that the promisor or obligor in a contract with a pretended corporation is estopped to deny the corporate existence in a suit by the corporation to enforce the obligation. This cannot be a case of true estoppel. It can hardly be said that a person who deals with a company which claims to be a corporation impliedly represents to it that it is incorporated, or that the supposed company or its members are misled by any such misrepresentation. It is sometimes said that the party who enters into a contract with an assumed corporation in its corporate name thereby *admits* it to be a corporation, and many cases hold that there is a binding recognition of its corporate existence for purposes of suit by the corporation on the contract. This rule then is not founded upon any principle of estoppel but upon broader principles of contract and business convenience.⁶⁵ If A who has contracted with an irregular corporation is attempting not to impose full liability upon the associates, but to escape liability and repudiate his own obligation, say for money which he has

⁶⁴ *Gardner v. Minneapolis & St. L. Ry. Co.*, 73 Minn. 517, 76 N. W. 282; *Scheufler v. Grand Lodge, A. O. U. W. of Minnesota*, 45 Minn. 256, 47 N. W. 799; 1 *Fletcher, Corporations*, sec. 343; *Pepper, Incidents of Irregular Incorporation*, 36 Am. Law Reg. (N. S.) 161, 43 Am. Law Reg. (N. S.) 409.

In Maryland this doctrine has been repudiated. It was there held that an association which held itself out as a corporation, and contracted as such, was not estopped, in an action against it on the contract, to deny their corporate existence on the ground that they had failed to comply with the requirements of the law in organizing. "We think," said the court, "it would be extending the doctrine of estoppel to an extent not justified by the principles of public policy to allow it to operate through the conduct of the parties concerned, to create substantially a *de facto* corporation, with just such powers as the parties may by their acts give to it. This would be substituting the dealings of the parties for compliance with the requirements of the law, and giving to them the same effect

through the aid of the courts. Thus, virtually, through the courts, recognizing the existence of the corporation, in manifest disregard of the written law." *Boyce v. Trustees of Townsontown Station of M. E. Church*, 46 Md. 359. Compare, however, *Grape Sugar & Vinegar Mfg. Co. v. Small*, 40 Md. 395. This seems clearly an erroneous view of the true policy, which would preclude the corporation from setting up defects against persons contracting with it.

⁶⁵ *Ingle System Co. v. Norris*, 132 Tenn. 472, 178 S. W. 1113, 5 A. L. R. 1578; *Lowell-Woodward Hardware Co. v. Woods*, 104 Kan. 729, 180 Pac. 734; *Johnston Harvester Co. v. Clark*, 30 Minn. 308, 15 N. W. 252; *Continental Ins. Co. v. Richardson*, 69 Minn. 433, 72 N. W. 458; *Minnesota Gas-Light Economizer Co. v. Denslow*, 46 Minn. 171, 48 N. W. 771; *Columbia Elec. Co. v. Dixon*, 46 Minn. 463, 49 N. W. 244; *Richards v. Minnesota Sav. Bank*, 75 Minn. 196, 77 N. W. 822; *French v. Donohue*, 29 Minn. 111, 12 N. W. 354. See also, 1 *Fletcher on Corporations*, § 334.

borrowed, should he be allowed to defend on the ground of the defective incorporation? It would seem that there is no need of recognizing such a defense either upon grounds of fairness between the parties or on public policy. This is usually expressed by saying that A is estopped to raise the issue.⁶⁶

§ 28. Estoppel to assert individual liability.—To come now to the third class of cases: Suppose that A sells goods to the B Company and later sues the associates C and D as partners or principals on the ground that the B Company was never in fact incorporated and is merely a trade name under which the individuals C and D are doing business. It is, of course, settled law that a creditor who deals with a corporation *de facto* and gives credit to it and not to its members or stockholders cannot charge them as partners for the debts of the corporation. But aside from the *de facto* doctrine, is there any basis for estopping A? If A has consented to deal with the B company as a corporation should he be allowed to claim an individual contract?

It is argued in numerous cases that persons who actively engage in business under the name and pretense of a corporation should be held individually liable where they have not achieved separate capacity. The fact that strangers are led by their pretense to contract with them as a corporate association is said to be no ground of estoppel in their favor. The associates are the principals and owners of the business, which is carried on by

⁶⁶ If the association sues A who has contracted with it as a corporation, A cannot set up irregularities in the organization as a defense against its right to sue as a corporation. *Commercial Nat. Bank v. Pfeiffer*, 108 N. Y. 242, 15 N. E. 701 [compare *Welland Canal Co. v. Hathaway*, 8 Wend. (N. Y.) 480, which is substantially overruled]; *Lynch v. Perryman*, 29 Okla. 615, 119 Pac. 229, Ann. Cas. 1913A 1065; *Swofford Bros. Dry Goods Co. v. Owen*, 37 Okla. 616, 133 Pac. 193, 197; *L. R. A.* 1916C 189; *Pape v. Capital Bank*, 20 Kan. 440, 27 Am. St. Rep. 183; *Plummer v. Struby-Estabrooke Mercantile Co.*, 23 Colo. 190, 47 Pac. 294; *Petty v. Brunswick & W. Ry. Co.*, 109 Ga. 666, 35 S. E. 82; *California Fruit Exch. v. Buck*, 163 Cal. 223, 124 Pac. 824; *Ingle System Co. v. Norris & Hall*,

132 Tenn. 472, 178 S. W. 1113, 5 A. L. R. 1578.

In Maryland, this doctrine has been repudiated, and it has been held that a person dealing with an association as a corporation is not thereby estopped to deny its corporate existence. *Maryland Tube & Iron Works v. West End Imp. Co.*, 87 Md. 207, 39 Atl. 620, 39 L. R. A. 810. And see *Bonaparte v. Baltimore, H. & L. R. R. Co.*, 75 Md. 340, 23 Atl. 784; *Boyce v. Trustees of Towsontown Station of M. E. Church*, 46 Md. 359. Cf. *Bartlett v. Wilbur*, 53 Md. 485, 498. See *Eastern Products Corporation v. Tennessee Coal, Iron & Railroad Co.*, 151 Tenn. 239, 269 S. W. 4, 40 A. L. R. 1483 (collateral attack allowed in suit to enforce contract where stock was not subscribed though incorporation was complete.)

their authorization and for their benefit. Just as promoters are held liable on contracts which they make on behalf of a proposed corporation, so the individual members of the association are treated as parties described by the name of the supposed corporation. By the weight of authority, it seems that where the attempt to comply with the incorporation law does not go far enough to create a corporation *de facto*, the associates may be held to full liability on contracts authorized or ratified by them, either as partners, or as principals.⁶⁷ Perhaps the strongest case on this point is *Harrill v. Davis*,⁶⁸ in which it is held that the associates cannot escape individual liability because strangers are misled to contract with the pretended entity as a corporation. There is no estoppel of one who deals with parties who masquerade under a name which represents no corporation *de facto*, because the elements of estoppel, viz., action induced by misrepresentation of the party against whom the estoppel is asserted, do not exist. The benefit of an estoppel cannot be claimed by one who is not misled.

Though the elements necessary to raise an estoppel strictly so called are not present, yet there are cases which hold, in view of the fact that the plaintiff consented to contract with the association on a corporate basis that there is an implied contractual limitation of liability to such remedies as could be used if the associates possessed corporate character or capacity.⁶⁹ On prin-

⁶⁷ Unless there is at least a corporation *de facto*, many courts hold that a creditor of the alleged corporation can hold active members liable as partners. *Central Nat. Bank of Junction City v. Sheldon*, 86 Kan. 460, 121 Pac. 340; *Wechselberg v. Flour City Nat. Bank* (but see dissenting opinion of Woods, J.), 64 Fed. 90; *Baker v. Bates-Street Shirt Co.*, 6 Fed. (2d) 854; *Harrill v. Davis*, 168 Fed. 187, 192, 22 L. R. A. (N. S.) 1153; *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123, 28 S. W. 668, 26 L. R. A. 509, 45 Am. St. Rep. 700; *Guckert v. Hacke*, 159 Pa. St. 303, 28 Atl. 245; *Martin v. Fewell*, 79 Mo. 401; *Kaiser v. Lawrence Sav. Bank*, 56 Iowa 104, 8 N. W. 772, 41 Am. St. Rep. 85; *Pilsen Brewing Co. v. Wallace*, 291 Ill. 59, 125 N. E. 714, 8 A. L. R. 579; *Bigelow v. Gregory*, 73 Ill. 197; *Taylor v. Branham*, 35 Fla. 297, 17

So. 552, 39 L. R. A. 362, 43 Am. St. Rep. 249; *Johnson v. Corser*, 34 Minn. 355, 25 N. W. 799; *Booth v. Scott*, 276 Mo. 1, 205 S. W. 633 (foreign corporation not admitted to do business); *Doyle Kidd, etc., Co. v. A. W. Kennedy & Co.*, 154 Ark. 573, 243 S. W. 66; *Pocahontas Fuel Co. v. Tarboro Cotton Factory* (foreign corporation), 174 N. C. 245, 93 S. E. 790; *Hill v. Turnverein Germania*, 77 Okla. 242, 187 Pac. 920. *Cf. American Soap Co. v. Bogue*, 20 Ohio App. 375, 152 N. E. 393.

⁶⁸ 168 Fed. 187, 22 L. R. A. (N. S.) 1153.

⁶⁹ In *Staver & Abbott Mfg. Co. v. Blake*, 111 Mich. 282, 69 N. W. 508, 38 L. R. A. 798, the court said: "The law does not permit A to deal and make contracts with B in one capacity, and then hold him liable in another. . . . These defendants have never agreed to be

ciple, should persons dealing with any defectively incorporated association on a corporate basis be estopped to deny the corporate character of the association and to hold the associates individually liable on contracts made in the corporate name, even where the *de facto* doctrine does not apply? Some writers have argued that the shareholders of the pretended corporation should not be held individually liable because they have not agreed to be so liable and to hold them to such liability would be the creation of a different contract from what either of the parties intended to make.⁷⁰

By some writers, on the other hand, it is contended that it is intolerable that A, B and C by merely assuming a corporate name and pretending to be a corporation can escape individual liability; that public policy demands liability as partners "because if business adventurers learn that unless their corporate organization is lawful and valid, they are liable as partners, this will

partners, and have never held themselves out to plaintiff or to the world as such. By the purchase of stock, they became members of a body, organized under a law, which made its capital and assets alone liable for its debts. This is the legal entity with which plaintiff dealt, made contracts, and to which it gave credit. . . . Upon what principle of common sense, justice or equity can it now be held that plaintiff, having trusted this entity, can recover its entire debt from one with whom it never contracted and who never promised to pay? . . . It had dealt with them and trusted them upon the strength of their limited liability. It had agreed to look to this alone, and the law will hold it to its understanding."

To the effect that if A contracts with a company where the defects are such that no *de facto* corporation can be recognized, yet having contracted on a corporate basis he cannot hold the members of the defectively organized corporation individually liable as parties or as partners, see *Stafford Nat. Bank v. Palmer*, 47 Conn. 443; *Brooke v. Day*, 129 Ga. 694, 59 S. E. 769; *Planters & Miners Bank v. Padgett*, 69 Ga. 159; *Ward v. Brigham*, 127 Mass. 24; *Salem First Nat. Bank v. Almy*, 117 Mass. 476; *Trowbridge v. Scudder*, 11 Cush. (Mass.) 83;

Fay v. Noble, 7 Cush. (Mass.) 188 (leading case); *Fuller v. Rowe*, 57 N. Y. 23 (but see *Zabriskie v. Coates*, 41 N. Y. App. Div. 316, 58 N. Y. Supp. 523); *Perrine v. Levin*, 68 N. Y. Misc. 327, 123 N. Y. Supp. 1007; *Blanchard v. Kaull*, 44 Cal. 440; *Rutherford v. Hill*, 22 Ore. 218, 29 Pac. 546, 17 L. R. A. 549, 29 Am. St. Rep. 596; *Swofford Bros. Dry Goods Co. v. Owen*, 37 Okla. 616, 133 Pac. 193, L. R. A. 1916C 189; *Tulane Imp. Co. v. S. A. Chapman & Co.*, 129 La. 562, 56 So. 509; *Pepper*, 36 Am. Law Reg. (N. S.) 161; 43 Am. Law Reg. (N. S.) 426; *Lewinsohn*, 13 Mich. Law Rev. 271; *Carpenter*, 8 Minn. Law Rev. 409, 25 Harv. Law Rev. 623. Compare, *Warren*, 20 Harv. Law Rev. 456, 21 Harv. Law Rev. 311.

⁷⁰ *Morawetz, Private Corporations* (2nd Ed.), § 748; *Clark on Corporations* (3rd Ed.), pp. 113, 122; *J. L. Lewinsohn, Liability to third persons, of associates in defectively incorporated associations*, 13 Mich. Law Rev. 271; *G. W. Pepper*, 36 Am. Law Reg. (N. S.) 161; *Carpenter, Are members of a defectively organized corporation liable as partners?* 8 Minn. Law Rev. 409; *G. W. Pepper, Irregular Associations*, 43 Am. Law Reg. (N. S.) 409, 413, 423, 426; *Magruder*, 40 Harv. Law Rev. 733.

deter them from attempting to form illegal or prohibited corporations.”⁷¹ This seems to conjure up an imaginary public concern in doing business as a corporation without formality. An abortive attempt at incorporation does not necessarily result in a partnership even if it does not produce a *de facto* corporation. As a question of fairness between the immediate parties to a contract, when A contracts with B & Company as a corporation he should not be enabled to claim that he was contracting with the individuals who were its stockholders, since they only consented to be bound with limited liability.⁷²

In some states, the doctrine that the stockholders or members of such an association are individually liable as partners, because of their membership merely, is repudiated on the ground that no such relation or liability is contemplated by them. It is accordingly held that the only remedy is against the officers or agents who made the contract, or against the assets of the company.⁷³ “Let it be supposed that X and others propose to organize a bank. They effect a corporate organization, but in fact obtain no charter. X represents to B that the bank is regularly incorporated. B subscribes to several shares of stock on the basis of this assurance. He receives dividends but takes no part in the manage-

⁷¹ Thompson, Corporations, sec. 506. See Warren, 21 Harvard Law Review, 313, 314. It is argued that to allow the associates to shield themselves from full liability by defective incorporation is contrary to public policy. The privilege of exemption from personal liability should be enjoyed only as the state permits. Burdick, Are defectively incorporated associations partnerships? 6 Columbia Law Rev. 1, 6; Dodd, 40 Harv. Law Rev. 521.

⁷² If the associates have assumed to do business as a corporation and the creditor understood that he was dealing with the association as a corporation this should be enough to carry an implied agreement for limited liability on the part of the associates, a tacit stipulation to look only to the funds of the association in event of litigation. This kind of estoppel would protect directors, managing agents and active stockholders as well as the nonparticipating stockholders. Snider's Sons' Co. v. Troy, 91 Ala. 224, 8 So. 658, 11 L. R. A. 515, 24 Am. St. Rep.

887; Lewinsohn, 13 Mich. Law Rev. 287.

⁷³ Blanchard v. Kaull, 44 Cal. 440; Planters' & Miners' Bank v. Padgett, 69 Ga. 159; Wesco Supply Co. v. Smith, 134 Ark. 23, 203 S. W. 6; Bond & Braswell v. Scott Lumber Co., 128 La. 818, 55 So. 468; Tulane Imp. Co. v. S. A. Chapman & Co., 129 La. 562, 56 So. 509; Hoyt v. McCallum, 102 Ill. App. 287; 14 Corpus Juris 987; Gartside Coal Co. v. Maxwell, 22 Fed. 197; Snider's Sons' Co. v. Troy, 91 Ala. 224, 8 So. 658, 11 L. R. A. 518, 24 Am. St. Rep. 887, “when a party deals and contracts with a corporation as corporators, exemption from individual liability enters as an element of the contract.” Bushnell v. Consolidated Ice Machine Co., 138 Ill. 67, 27 N. E. 596. Compare, however, Wechselberg v. Flour City Nat. Bank, 24 U. S. App. 308, 64 Fed. 90, 26 L. R. A. 470; Kaiser v. Lawrence Sav. Bank, 56 Iowa 104, 8 N. W. 772, 41 Am. Rep. 85; Guekert v. Hacke, 159 Pa. St. 303, 24 Atl. 249.

ment of the business. X and the other officers carry on the business in corporate form and A makes a deposit in the belief that the institution is an incorporated bank. A subsequently ascertains the facts and sues B for this deposit. Here B never gave to X anything but a limited authority. B should not be held liable to A."⁷⁴ B does not participate in the business of the company, even to the extent of voting his stock for directors by proxy. Is B to be considered as a partner or a principal in the conduct of the business? Is he not merely a contributor of capital whose rights and liabilities ought to be worked out on a corporate basis?⁷⁵

In a number of jurisdictions it is, however, held that a person who enters into a written contract with a pretended corporation, where there is no sufficient organization for a *de facto* corporation, is not estopped from showing that the corporate name was merely a name under which the individuals with whom he dealt were masquerading, because the elements of an estoppel, action induced by misrepresentation, do not exist. Thus in a Colorado case it was said that "the doctrine of estoppel cannot be successfully invoked, we think, unless the corporation has at least a *de facto* existence."⁷⁶ Under the partnership theory of liability, membership in the association, as by the holding of one share of stock is all that is required for unlimited joint liability on contracts and debts.⁷⁷ On the theory of the liability of an agent for

⁷⁴ Pepper, 43 Am. Law Reg. (N. S.) 426; In re Western Bank & Trust Co., 163 Fed. 713. In this case it was sought to fix upon every shareholder in a bank the liability of a partner, a liability to the creditors of the concern for the whole amount of every debt without reference to the number of shares owned. These holders lived in various parts of the country and had purchased their shares after organization as an investment in what they believed to be a legal corporation. They had nothing to do with the management of its affairs. It was held that even if the bank were not a *de facto* corporation, the creditors by their course of dealing with it as such were estopped to deny that it was a corporation.

⁷⁵ Hallstead v. Coleman, 143 Pa. 352, 22 Atl. 977, 13 L. R. A. 370; Gibbs' Estate, 157 Pa. 59, 27 Atl. 383, 22 L. R. A. 276; Hoyt v. McCallum, 102 Ill. App. 287. The stock-

holders have never authorized any of the agents or members of the associations to bind them personally or transact any business for them. There has never been represented to be any agency for any principal except the association. The creditor has dealt with and trusted the association alone. See Magruder, 40 Harv. Law Rev. 733.

⁷⁶ Jones v. Aspen Hardware Co., 21 Colo. 263, 268, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220; Cottentin v. Meyer, 80 N. J. L. 52, 76 Atl. 341; Harrill v. Davis, 168 Fed. 187, 22 L. R. A. (N. S.) 1153; In re Ballard, 279 Fed. 574, 596. See note, Partnership liability of stockholders in case of defective incorporation, L. R. A. 1916C 196, 212.

⁷⁷ Kaiser v. Lawrence Sav. Bank, 56 Iowa 104, 8 N. W. 772, 41 Am. Rep. 85; Eaton v. Walker, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; Dodd, 40 Harv. Law Rev. 521, 550.

impliedly warranting the competency of the principal to contract, or on the theory of principal and agent (aside from partnership), active participation by the defendants is the operative fact. To hold the purchaser of one or two shares of stock liable to creditors as a partner on account of defects in organization may make the corporate form a trap to the unwary purchaser of stock.⁷⁸

Parties who actively engage in business for profit under the name and pretense of a corporation which they know has no legal existence may perhaps be held individually liable to those who are led by their pretense to contract with them as a corporation. In such a case they may be held liable on the ground they were acting as agents of a principal that did not exist and impliedly warrant their authority, or perhaps as being themselves in effect principals if not partners.⁷⁹ But stockholders who took no active part in the business of a pretended corporation and who supposed that the corporation was duly organized should be held exempt from individual liability for its debts.⁸⁰

§ 29. Requisites for corporation by estoppel.—Some courts have held, on the theory that the doctrine of estoppel is limited to *de facto* corporations, that there is no estoppel to deny the existence of a pretended corporation, where there is no law under which it might exist, or, what amounts to the same thing, if the

⁷⁸ *Baker v. Bates-Street Shirt Co.*, 6 Fed. (2d) 854. Persons who subscribe for and take stock in a supposed corporation but who take no part in the active conduct of the business or making contracts are not partners, liable individually for debts, though the organization is neither a corporation *de jure* or *de facto*, citing *Fay v. Noble*, 7 Cush. (Mass.) 188, 192, 193; *Rutherford v. Hill*, 22 Ore. 218, 29 Pac. 546, 17 L. R. A. 549, 29 Am. St. Rep. 596.

⁷⁹ In *Roberts Mfg. Co. v. Schlick*, 62 Minn. 332, 64 N. W. 826, it is held that if there is not a corporation *de facto* those who engage in the business, or authorize or ratify contracts come under an individual liability on contracts made in the name of the proposed corporation, as principals if not as partners. The defense of estoppel apparently was not urged by the defendant's counsel. 1

Fletcher, Corporations, § 294, 298; 6 Minn. Law Rev. 357; 8 Minn. Law Rev. 409; 40 Harv. Law Rev. 551, 746.

⁸⁰ One who merely undertakes to become a stockholder in a proposed private corporation, which fails to acquire such color of legal existence as to be entitled to claim that it is a corporation *de facto*, does not thereby expose himself to individual liability to obligations incurred in the name of the proposed corporation without his participation or authorization. It is different from a case where formation of a corporation is a mere sham. *Magnolia Shingle Co. v. J. Zimmern's Co.*, 3 Ala. App. 578, 58 So. 90. See *Wheeler & Motter Mercantile Co. v. Lamerton*, 8 Fed. (2d) 957, 44 A. L. R. 769, 776n, signing articles of incorporation as rendering one liable on contracts entered into prior to incorporation.

statute under which it claims to exist is unconstitutional.⁸¹ This, however, cannot be sustained on principle, and is contrary to the weight of authority. The doctrine of estoppel to deny incorporation does not depend at all on the right to be a corporation, or on the existence of a corporation *de facto*, and therefore persons who hold themselves out as a corporation, or who deal with a pretended corporation, may be estopped to deny incorporation, whether there is any valid law authorizing such a corporation or not.⁸²

Whether the corporation be one *de jure* or *de facto* or one more seriously irregular, there is no practical utility in permitting a private person who enters into a contract with a body purporting to be a corporation in which it is described by a name which implies a corporation to raise an issue as to the character of the organization to which he is indebted. It would be only in very exceptional cases when any irregularity in its incorporation would affect his substantial rights or have any bearing upon his obligation or liability. For example, a stockholder in a pretended corporation is estopped to set up the unconstitutionality of the statute under which corporate existence has been claimed, for the purpose of escaping constitutional or statutory liability for its debts.⁸³ But where a corporation continued to act as such and entered into a contract after the forfeiture of its charter, it was held that one contracting with it was not estopped to deny its corporate existence and powers in an action on the contract, because this would be practically to nullify the statute under which the forfeiture of its charter had been declared and would cast upon the state the burden of instituting proceedings in *quo warranto* against every such corporation to enforce the forfeiture which the statute declared.^{83a}

⁸¹ *Brandenstein v. Hoke*, 101 Cal. 131, 35 Pac. 562; *Heaston v. Cincinnati & Ft. W. R. Co.*, 16 Ind. 275, 79 Am. Dec. 430; *Snyder v. Studebaker*, 19 Ind. 462, 81 Am. Dec. 415; *Jones v. Aspen Hardware Co.*, 21 Colo. 263, 40 Pac. 457, 52 Am. St. Rep. 220; *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Imperial Bldg. Co. v. Chicago Board of Trade*, 238 Ill. 100, 87 N. E. 167.

⁸² *Smith v. Sheeley*, 12 Wall. (U. S.) 358, 20 L. Ed. 430; *McDonnell v. Alabama Gold Life Ins. Co.*, 85 Ala. 401, 5 So. 120; *Gardner v. Minneapolis & St. L. Ry. Co.*, 73

Minn. 517, 76 N. W. 282; *Freeland v. Pennsylvania Cent. Ins. Co.*, 94 Pa. St. 504; *Black River Improvement Co. v. Holway*, 85 Wis. 344, 55 N. W. 418; *Lynch v. Perryman*, 29 Okla. 615, 119 Pac. 229, Ann. Cas. 1913A 1065; *Council v. Brown*, 151 Ga. 564, 107 S. E. 867.

⁸³ *McDonnell v. Alabama Gold Life Ins. Co.*, 85 Ala. 401, 5 So. 120; *Gardner v. Minneapolis & St. L. Ry. Co.*, 73 Minn. 517, 79 N. W. 282.

^{83a} *Van Landingham v. United Tuna Packers*, 189 Cal. 353, 208 Pac. 973, noted 11 California Law Review 40. It did not appear that

Necessity for recognition or holding out of association as a corporation.—The doctrine in relation to estoppel to deny the corporate existence of an association is always based upon some dealing showing either recognition of the association as a corporation, or an express or implied representation that it is a corporation, and it cannot apply, therefore, to one who has not dealt with the association or in any way recognized it as having a corporate existence, or in any way participated in holding it out as a corporation. One may be prevented, by the doctrine in relation to *de facto* corporations, from questioning a corporation's existence without any such conduct on his part, but he cannot be estopped if there is no recognition of or dealing with it.⁸⁴ Thus, a person claiming title to land by adverse possession cannot be estopped to attack a conveyance of the land to a pretended, but not *de facto*, corporation, which he has in no way recognized.⁸⁵

Recognition of an association as a corporation is not necessarily to be implied from the mere fact of dealing with it for it may be dealt with as an unincorporated association. A person, therefore, who deals with the agent of an association, is not thereby estopped to deny that it is a corporation, where he does not know that it claims to be a corporation, but supposes that it is doing business as an unincorporated association.⁸⁶ It must have been dealt with or treated *as a corporation*. If the conduct of the party is just as consistent with the existence of an unincorporated association as with the existence of a corporation, there is no estoppel.⁸⁷ In some of the cases it has been held that making a note or other contract to an association, or taking one from it, in a name which is ordinarily, though not necessarily, taken as

the plaintiff had expended any money or changed his position in reliance on the contract, or that defendant had received any benefit therefrom. But such elements of equitable estoppel are not required to preclude one who has dealt with a corporation from contesting its existence in ordinary cases where no statute forbids the exercise of corporate powers.

⁸⁴ *Marion Sav. Bank v. Dunkin*, 54 Ala. 471; *Schloss v. Montgomery Trade Co.*, 87 Ala. 411, 6 So. 360, 13 Am. St. Rep. 51; *Bradley v. Reppell*, 133 Mo. 545, 32 S. W. 645, 34 S. W. 841, 54 Am. St. Rep. 685;

Tonge v. Item Pub. Co., 244 Pa. 417, 91 Atl. 229.

⁸⁵ *Bradley v. Reppell*, 133 Mo. 545, 32 S. W. 645, 34 S. W. 841, 54 Am. St. Rep. 685.

⁸⁶ *Martin v. Fewell*, 79 Mo. 401; *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Tonge v. Item Pub. Co.*, 244 Pa. 417, 91 Atl. 229.

⁸⁷ *Schloss v. Montgomery Trade Co.*, 87 Ala. 411, 6 So. 360, 13 Am. St. Rep. 51; *Christian & Craft Grocery Co. v. Fruitdale Lumber Co.*, 121 Ala. 340, 25 So. 629; *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Guckert v. Hacke*, 159 Pa. St. 303, 28 Atl. 249.

implying a corporation, does not even *prima facie* estop one from denying that the association is a corporation, where there is no recital in the contract that it is a corporation, since an unincorporated association may thus do business in a name which would be appropriate to a corporation.⁸⁸

In *Welland Canal Co. v. Hathaway*⁸⁹ it was held that the fact of a party entering into a contract with an association and giving a receipt to the association in the name of the Welland Canal Company did not estop him from denying it to be a body corporate or relieve the association from proving itself to be a corporation when it sued as such and the general issue was pleaded. The court said that the receipt and contract merely showed the fact of an association acting under a particular name, but the defendant had neither admitted the legal existence of the plaintiff as a corporation, nor done anything by which he was estopped from denying it. The better opinion, however, is to the contrary,—that is, to the effect that there is at least a *prima facie* admission and estoppel, if the name used is one which is generally considered as importing a corporation, rather than a mere unincorporated association.⁹⁰

In a Tennessee case,⁹¹ the defendants executed a note to the “*Ingle System Company*.” The note did not recite that the company was a corporation. No proof was introduced in the action on the note to show that fact other than the introduction of

⁸⁸ See *Duke v. Taylor*, 37 Fla. 64, 19 So. 172, 31 L. R. A. 484, 53 Am. St. Rep. 232 (where a person took a note signed “Florida Orange Hedge Fence Company, by its President John W. Childress, James A. Knox, as Secretary and Treasurer”); *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Guckert v. Hacke*, 159 Pa. St. 303, 28 Atl. 249.

⁸⁹ 8 Wend. (N. Y.) 480, 24 Am. Dec. 51. It was argued that the fact that the plaintiffs held themselves out to the world as a corporate body and that the defendant contracted with them under the supposition that these professions were correct would not raise an estoppel against him or be an admission of anything more than appeared on the face of the contract. *Acc. Holloway v. Memphis, E. P. & P. R. Co.*, 23 Tex. 465, 76 Am. Dec. 68; *Provident Bank & Trust Co. v. Saxon*, 116 La. 408,

40 So. 778. See *Guckert v. Hacke*, 159 Pa. St. 303, 28 Atl. 249; *Seufert v. Gille*, 230 Mo. 453, 131 S. W. 102, 31 L. R. A. (N. S.) 471.

⁹⁰ *Platte Valley Bank v. Harding*, 1 Neb. 461; *Exchange Nat. Bank v. Capps*, 32 Neb. 242, 49 N. W. 223, 29 Am. St. Rep. 433; *Stoutimore v. Clark*, 70 Mo. 471; *Studebaker Bros. Mfg. Co. v. Montgomery*, 74 Mo. 101; *Mitchell v. Deeds*, 49 Ill. 416, 95 Am. Dec. 621; *Estey Mfg. Co. v. Runnels*, 55 Mich. 130, 20 N. W. 823; *Guckert v. Hacke*, 159 Pa. St. 303, 28 Atl. 249.

⁹¹ *Ingle System Co. v. Norris*, 132 Tenn. 472, 178 S. W. 1113, 5 A. L. R. 1578. The name “Company” is *prima facie* that of a corporation and not of a firm, and will be so treated by way of presumption in the absence of proof. See *Lowell-Woodward Hardware Co. v. Woods*, 104 Kan. 729, 180 Pac. 734.

the note or contract. The court held that it might be fairly assumed from the name of the company that it was a corporation. One who executes a contract to an obligee by a name which imports that it is a corporation is estopped to deny its corporate existence, and the mere introduction of the contract in evidence will make out a *prima facie* case that the contract is with a corporation.

In order that members or agents of an association may be estopped to deny that it is a corporation on the ground that they have held it out as a corporation, the acts relied upon must be equivalent to a representation or admission of corporate existence, and therefore will not operate as an estoppel, if they are just as consistent with the existence of an unincorporated association as with the existence of a corporation. As was said by the Alabama court: "To warrant holding a person estopped from disputing the existence of a corporation, on the ground that he has cooperated in its organization and action, the acts shown must be unmistakably corporate acts. If the act done, or admission made, is just as consistent with the existence of an unincorporated association, as of one incorporated, its ambiguous character will be so equivocal as not to raise an estoppel."⁹²

Liability for torts.—Persons who assume to do business as a corporation, without either a *de jure* or a *de facto* corporate existence, as because of their failure to file articles of association, are liable, as partners are, for the torts of their agents or employees in the course of the business.⁹³

§ 30. Implied warranty of corporate capacity by officers and agents.—Persons who assume to contract as officers or agents of a pretended corporation may be held individually liable, unless the association is a corporation *de facto*, or unless the person dealing with them is estopped to deny its corporate existence. In some states, such liability is imposed by statute. It is a familiar

⁹² *Schloss v. Montgomery Trade Co.*, 87 Ala. 411, 6 So. 360, 13 Am. St. Rep. 51. And see *Fredenburg v. Lyon Lake M. E. Church*, 37 Mich. 476; *Bash v. Culver Gold Min. Co.*, 7 Wash. 122, 34 Pac. 462; *Baxter v. Jones*, 185 Fed. 900. The mere fact of the plaintiff doing business under the name of Newport Pressed Brick Company works no absolute estoppel against the company to re-

sist enforcement of a judgment against the property of a partnership doing business under that name.

⁹³ Stockholders or members are individually liable for torts committed in the course of the business of a pretended corporation. *Mandeville v. Courtwright*, 142 Fed. 97, 6 L. R. A. (N. S.) 1003 (*ultra vires*); *Smith v. Warden*, 86 Mo. 382 (foreign limited partnership).

principle of the law of agency that a person who acts as agent without authority, or for a principal, who does not exist or is incompetent, is liable upon an implied warranty of authority. This doctrine applies when persons assume to act for a corporation which has no existence or is not competent to contract. If persons, therefore, purporting to act as officers or agents of a corporation which has no existence, either *de jure* or *de facto*, make contracts or do other acts as agents, they become personally liable. Some courts put this on the theory that the persons who actively participate in making the contracts are to be regarded as principals.⁹⁴ In some states, the liability cannot be enforced by action on the contract, but the remedy is by action sounding in tort, or for implied warranty of authority.⁹⁵ Officers and agents of an association held out as a corporation are not personally liable on contracts made by them for the association if it has a *de facto* corporate existence, or if the other party to the contract is estopped to deny its corporate existence.⁹⁶

Where there is no provision in the statutes expressly declaring that persons representing foreign corporations doing business in the state without compliance with statutory conditions, or its officers or stockholders, shall be personally liable for its obligations, it would seem that creditors should pursue the corporation, but there is some conflict of authority.⁹⁷

⁹⁴ *Fay v. Noble*, 7 Cush. (Mass.) 188; *Montgomery v. Forbes*, 148 Mass. 249, 19 N. E. 342; *Walton v. Oliver*, 49 Kan. 107, 30 Pac. 172, 33 Am. St. Rep. 355. See as to liability of promoters, post, §§ 46, 47; as to officers and directors, see post, § 118.

⁹⁵ *Blanchard v. Kaull*, 44 Cal. 440; see *Seeberger v. McCormick*, 178 Ill. 404, 53 N. E. 340; *Mechem, Agency*, sec. 549. See 42 A. L. R. 1310n; 12 Cornell Law Quart. 192.

⁹⁶ *Perkins v. Fish*, 121 Cal. 317, 53 Pac. 901. Action against defendants as agents and managers of the so-called "Home Benefit Life Association." Even if there was neither a *de jure* nor a *de facto* corporation behind the defendants, yet where plaintiff has dealt with the

association as a corporation he cannot hold the agents and directors personally liable for money paid the association.

⁹⁷ It has been held that stockholders in a foreign corporation doing business as such in a state without attempting to comply with the statutory requirements relating to the admission of foreign corporations are liable on contracts as partners, though made in the name of the corporation and though they did not know of such noncompliance. *Equitable Trust Co. v. Central Trust Co.*, 145 Tenn. 148, 239 S. W. 171; *Cunningham v. Shelby*, 136 Tenn. 176, 188 S. W. 1147, L. R. A. 1917B 572. But see *Martin Bros. v. Nettleton*, 138 Wash. 102, 244 Pac. 386; 27 Yale Law Journ. 248.

CHAPTER IV.

SUBSCRIPTIONS FOR STOCK.

I. WHEN A SUBSCRIBER BECOMES BOUND AND WHEN HE BECOMES A STOCKHOLDER.

§ 31. Present subscriptions.—A present subscription is an agreement to become a stockholder, which on acceptance by the corporation makes one a stockholder even though a certificate of stock may not be delivered or tendered to the subscriber. He is as such bound to pay the amount of the subscription when called, and the corporation is bound to issue a certificate of stock and to admit him to the rights and privileges of a stockholder.

Formerly a preliminary subscription list was regarded as an essential step to incorporation in order to assure sufficient support to justify the formation of the company, and to commit the subscribers before organization was undertaken. Now the corporation is usually organized first, property is taken over and stock issued in payment. Then subscriptions are solicited or stock is sold to raise the needed capital. The real subscriptions for shares are made after the preliminary organization. A person may become a stockholder either by a subscription contract with the corporation for the issue of shares, or by the purchase of treasury stock from the corporation or by transfer of shares from some shareholder by which he is substituted in his place. To become a stockholder by subscription, no particular formalities are necessary. It must simply appear that the subscriber applied for stock and that the corporation accepted his application, expressly or impliedly. The term "subscription" is used rather loosely, but strictly a subscriber is one who has agreed with the corporation to take a certain number of shares in the corporation by original issue. The agreement of present subscription creates a kind of status, that of shareholder from which flow certain rights and liabilities. The obligation to pay the par value of the shares subscribed may be regarded as an obligation imposed by law on the basis of the relationship rather than as arising from a promise

to pay a certain purchase price. There is danger of serious confusion unless the distinctions are carefully observed between a subscription and a purchase of shares, between a present subscription and an agreement to subscribe, between a subscription accepted by the corporation which gives the full status of shareholder and vests the subscriber with the right and liabilities of membership, and subscription as a binding, irrevocable contract among subscribers to become a shareholder which does not make one a shareholder until assented to by the corporation.

Subscription after corporation is formed.—In the case of subscriptions for stock after a corporation has been formed and is in existence, the subscriber becomes a stockholder simply by mutual assent. No formal contract is required. Issuance of certificates of stock is not necessary, nor payment according to the better authority. There must simply be an offer and an acceptance, as in the case of any other contract. When a corporation solicits subscriptions to its stock, intending merely to solicit the *submission* of subscriptions, a subscription is like an offer in the formation of any other contract. Until it is accepted by the corporation, or an authorized agent of the corporation, there is no contract, and neither party is bound. A solicitation of subscriptions by an existing corporation may be intended, not merely as an invitation to submit subscriptions for acceptance by the corporation, but as an *offer* of membership by the corporation to any person who may subscribe in accordance with the terms of the offer. In such a case, a subscription in accordance with the terms of the offer is an acceptance of the offer, and creates the relationship of stockholder in the corporation.¹ The effect of a present subscription, the company being in existence at the time of the subscription, and having accepted the same, and the subscription being unconditional, is to make the subscriber a stockholder in the corporation, and to bind him to pay for his stock in accordance with the terms of his contract.²

A subscription for stock, and a contract to purchase stock from a corporation, are not the same, and are sometimes difficult to dis-

¹ Kennebec Housing Co. v. Barton, 123 Me. 293, 122 Atl. 852. The offer came from the corporation. "The contract was complete when the so-called 'pledge card' was signed and delivered to the solicitor authorized to receive it."

² Eastern States Agricultural & Industrial Exposition v. Vail's Estate, 96 Vt. 517, 121 Atl. 415; Hughes Mfg. & Lumber Co. v. Wilcox, 13 Cal. App. 22, 108 Pac. 871.

tinguish. A contract for the sale of stock does not make the purchaser a subscriber or a stockholder until it is executed by delivery of the stock. But a tender of a stock certificate is not a condition precedent to an action by the corporation to recover on a subscription, unless by express provision. Whether a particular contract is a subscription or a sale of stock depends upon its terms and the intention of the parties. The use of the words "subscribe," "sale," or "purchase" is not conclusive.³

Tender or delivery of certificate for stock.—In the case of a contract to purchase shares the delivery of the certificates and the payment of the price are usually intended by the parties to be concurrent acts. Neither party can ordinarily sue the other without a tender of performance, and the purchaser will not become a shareholder until the certificates have been indorsed and delivered. But in case of a subscription it is not ordinarily necessary either that the certificates be tendered or that the subscription price be paid. It is well settled that the issue or tender of a certificate of stock is not a condition precedent to the right of a corporation to make calls or maintain an action on a subscription for stock. A certificate of stock is merely evidence of the holder's ownership of stock, and is not at all necessary to make one a stockholder or liable as such.

In a suit on a promissory note given and accepted in payment of shares of stock in a corporation, a defense is not made out merely by a plea and proof that no certificate of stock has been delivered or tendered to the subscriber. The Minnesota Court said,⁴ "Plain-

³ *Lincoln Shoe Mfg. Co. v. Sheldon*, 44 Neb. 279, 62 N. W. 480; *Kennebec Housing Co. v. Barton*, 123 Me. 293, 122 Atl. 852 (use of word "purchase" in subscription contract does not show it a sale rather than a subscription); *Galbraith v. McDonald*, 123 Minn. 208, 143 N. W. 353, L. R. A. 1915 A 464, 468n. *Guaranty Mortg. Co. v. Wilcox*, 62 Utah 184, 218 Pac. 133, 30 A. L. R. 1324. "There is a clear distinction between an agreement to subscribe for stock in a prospective corporation to be organized, and an agreement to purchase unsold and unissued stock of an organized corporation, which is a going concern." A contract by a going company to issue increased shares of its preferred stock was held to be a sale

within the so-called "Blue Sky Law" which requires a license for sales, although defendant had executed a so-called subscription agreement. Compare *Planter's Warehouse Co. v. Sentelle*, 148 Tenn. 353, 255 S. W. 589. A corporation may sell treasury stock, which has once been issued and acquired by the corporation, as the stock is regarded as being already created and issued by the original subscription. *Sherman v. Shaughnessy*, 148 Mo. App. 679, 129 S. W. 245.

⁴ *Galbraith v. MacDonald*, 123 Minn. 208, 143 N. W. 353, L. R. A. 1915 A 464, Ann. Cas. 1915 A 420. Brown, C. J., dissented upon the ground that the duties of the parties were dependent and concurrent and that neither could seek affirmative

tiff contends that the transaction between defendant and the corporation amounted to a subscription to a share of stock; and defendant, that it was a contract of sale. There is no statute prescribing the mode in which a person may become a shareholder in a corporation. Previous to organization it is necessarily through subscription to shares of stock to be issued; after incorporation it may also be by subscription, or by purchase from the corporation direct or from other owners of its stock."

In another Minnesota case ⁵ defendants signed for fifty shares of stock under a stock subscription in the following form:

"We the undersigned, severally subscribe for and agree to take and pay for the number of shares set opposite our names, respectively, of the capital stock of the Walter A. Wood Harvester Company (being the same corporation formerly known as the Minneapolis Harvester Works), of the par value of one hundred dollars each.

"These subscriptions shall become binding as soon as stock in the said company to the amount of \$1,500,000 at par value shall have been subscribed for, . . . The payment of subscriptions shall be made in instalments as called for by the board of directors of said company, and at such times as said board shall direct, provided that not more than fifty per cent thereof shall be called for or be payable within one year from the first day of January, A. D. 1892."

The court held that this was a subscription for stock, not a sale of stock, and that a tender of the stock by the corporation before bringing suit was not necessary; that it was sufficient to allege and prove that plaintiff is ready and willing to deliver the stock on receiving payment.

relief without first tendering performance on his part. He cited 93 American St. Reports 352, 386. But the liability of a present subscriber to stock is upon debt arising from his membership, not upon a promise or contract. Fletcher Corporations, vol. 2, sec. 571.

⁵ Walter A. Wood Harvester Co. v. Johnson, 71 Minn. 367, 74 N. W. 149. Compare Stern v. Mayer, 166 Minn. 346, 207 N. W. 737.

The law is well settled that it is no defense to an action on a subscription to allege that the corporation has not delivered or tendered to the defendant the certificate of

stock to which he is entitled. Sanger v. Upton, 91 U. S. 56, 23 L. Ed. 220; Upton v. Tribilecock, 91 U. S. 45, 23 L. Ed. 203; Burr v. Wilcox, 22 N. Y. 551. See Cook on Corporations (8th Ed.), vol. 1, p. 603, § 192, and cases there cited. In the case of a subscription for stock, as distinguished from a sale of stock, the corporation would not have to be ready and willing to deliver the stock subscribed for, and its bankruptcy and inability to issue the stock would be no defense to the subscriber who would have to pay up to the par value for the benefit of creditors.

In a later case⁶ a subscription contract was construed not to give the defendant anything except a prospective right to become a stockholder at a future time contingent upon his making payment of all installments. This was construed as an executory contract of sale and purchase, and so bankruptcy of the corporation was a defense.

Payment as a condition.—There is some conflict of authority on the question whether the mere fact of subscribing or agreeing to take a new issue of stock of an existing incorporated company will *per se* constitute such subscriber a stockholder. Some courts have held that the subscription is but a contract to issue stock on payment, and to constitute the subscriber a stockholder, payment is necessary.⁷ But this does not seem to be the general view as to the effect of a subscription made after the corporation comes into existence. It is generally held that this puts it in the power of the corporation to compel the subscriber to pay for the shares subscribed and to give creditors the security of subscriptions for stock.⁸

⁶ *Stern v. Mayer*, 166 Minn. 346, 207 N. W. 737, 46 A. L. R. 1167. Where corporation after making an executory contract for the sale of stock, becomes bankrupt, the corporation becomes disabled from performance and the purchaser is excused. It would be otherwise if the contract were construed as a subscription, giving the subscriber upon acceptance the status of a stockholder. The court was liberal in its construction in favor of the unfortunate subscriber and against the creditors. Compare, *Granger & Co. v. Allen*, 214 N. Y. App. Div. 367, 212 N. Y. Supp. 356, 360. The fact that a subscriber has not received a stock certificate and is not entitled to receive one until his subscription is fully paid, does not affect the right of creditors to hold him liable for the unpaid balance due as a stockholder. Note; status and liability of one who subscribes for shares on an instalment basis, 11 Cornell Law Quarterly, 237.

⁷ That one who subscribes for stock in an existing corporation, already organized and incorporated does not thereby become a stockholder until he has paid for his stock. *Baltimore City Pass. Ry. Co. v. Hambleton*, 77 Md. 341, 26 Atl.

279; *Bole v. Fulton*, 233 Pa. 609, 82 Atl. 947; *St. Paul, S. & T. F. R. Co. v. Robbins*, 23 Minn. 439; *Wright v. Hix*, 203 Ala. 425, 83 So. 341, 346, 348. But see contra, *Marson v. Deither*, 49 Minn. 423, 52 N. W. 38; *Reagan v. Midland Packing Co.*, 298 Fed. 500.

⁸ *Reagan v. Midland Packing Co.*, 298 Fed. 500. Subscribers for stock of existing corporation are liable for corporate debts to the extent of the unpaid subscription. All of those who agree to take an original issue of stock should be regarded as subscribers rather than purchasers, whether the agreement was made before or after the articles are filed. *Smith v. General Motors Corporation*, 289 Fed. 205. By subscription agreement vesting of some of the rights of a stockholder may be postponed without destroying the character of the transaction as a subscription; e. g., that dividends are not to accrue to the subscriber unless he had paid in full before their declaration.

American Pig Iron Storage Co. v. State Board of Assessors, 56 N. J. Law 389, 29 Atl. 160, a corporation is said to "issue stock" when it obtains subscriptions. Neither certificates of stock nor payment of the par value of the shares is necessary

§ 32. Distinction between a present subscription and an executory agreement to subscribe in the future.—An agreement, not intended as a present subscription, but as a promise to subscribe in the future, will not of itself even if accepted by the corporation, constitute the promisor a stockholder or impose the liability upon him to pay up the par value of the stock upon calls made by the corporation, but he is liable in damages for breach.

A distinction is drawn between a contract of present subscription and a contract to become a shareholder at a future time. This latter is more like a contract to purchase shares which have already been issued. A contract of present subscription between subscriber and corporation gives the subscriber the full status of a shareholder and invests him with the rights and corresponding liabilities of that relation, such as the obligation to pay the full par value of the shares, without any further act or assent on his part. It is sometimes difficult to ascertain the intention of the parties whether any further act or assent on the part of the subscriber is contemplated such as formally becoming a subscriber on the books of the corporation or otherwise. The only remedy of the corporation, in case of the party's refusal to subscribe in accordance with the executory agreement, is an action against him for damages for breach of the agreement, and the measure of damages is not necessarily the par value of the stock agreed to be taken, but the actual loss sustained by the corporation. This distinction was made in an Illinois case, in which persons subscribed an instrument reciting: "We, the undersigned, agree to subscribe to the stock of the Pike County Railroad the sums set against our names, when the books may be opened for subscription." The defendant refused to subscribe when the books were opened. The corporation sued for breach of contract and also on the common counts for 100 shares of stock bargained and sold to the defendant. It was held that this was not a subscription for stock, making the signers stockholders in the corporation, and liable to calls, but a mere executory agreement to subscribe when the subscription books should be opened, for breach of which the company could only claim as damages the actual loss sustained by it, which, as a general rule, is the difference between the actual and the par value of the stock.⁹

to confer on the subscribers the rights and privileges of stockholders in the organization and management of the company.

⁹ Thrasher v. Pike County R. Co., 25 Ill. 393, 405. See, also, Quick v. Lemon, 105 Ill. 578; Mt. Sterling Coal Road Co. v. Little, 14 Bush

Ordinarily, however, when persons sign a subscription paper, agreeing to take a certain number of shares in a corporation to be formed, their intention is to bind themselves as subscribers, and to become stockholders as soon as the corporation is formed. No further act or assent by the subscriber such as signing some paper or book is contemplated after the corporation has been formed; and therefore, unless a contrary intention clearly appears, an instrument by which the signers agree to take shares in a corporation when formed should be construed, not as a mere agreement to subscribe in the future, but as a continuing offer to the corporation to take shares, which, when the corporation is formed and accepts the same, creates the relation of stockholder, giving the corporation a right of action against the subscribers for the amount of their subscriptions.¹⁰

Underwriting agreements and subscriptions.—An underwriting contract is “an agreement made before corporate shares are brought before the public, that, in the event of the public’s not taking all of the shares or the number mentioned on the agreement, the underwriter will take the shares which the public does not take.”¹¹ Such agreements would seem to be in the nature of an

(Ky.) 429; *Charlotte & S. C. R. Co. v. Blakely*, 3 Strob. (S. C.) 245; *Strasburg R. Co. v. Echternacht*, 21 Pa. St. 220, 60 Am. Dec. 49; *Webb v. Moeller*, 87 Conn. 138, 87 Atl. 277; *Lake Ontario Shore R. Co. v. Curtiss*, 80 N. Y. 219; *Sanders v. Barnaby*, 166 N. Y. App. Div. 274, 151 N. Y. Supp. 580; *Yonkers Gazette Co. v. Taylor*, 30 N. Y. App. Div. 334, 337, 51 N. Y. Supp. 969; *Van Schaick v. Mackin*, 129 N. Y. App. Div. 335, 113 N. Y. Supp. 408. See 93 Am. St. Rep. 352n.

¹⁰ *Bullock v. Falmouth & C. H. Turnpike Road Co.*, 85 Ky. 184, 3 S. W. 129, overruling *Mt. Sterling Coalroad Co. v. Little*, 14 Bush (Ky.) 429. See also, *North Missouri R. Co. v. Miller*, 31 Mo. 19; *Mobile & O. R. Co. v. Yandal*, 5 Sneed (Tenn.) 294. See 1 Cook, Corporations, sec. 71; 14 C. J., Corporations, § 780; 93 Am. St. Rep. 352, 353n.

¹¹ The plaintiff corporation sued upon an agreement whereby each signer bound himself to “the underwriting of the number of shares set opposite his signature,” and which permitted the company to sell the

stock to others at a certain price, and required signers to take only pro rata stock undisposed of. Held, that this was in fact an underwriting agreement rather than a subscription for stock, and was unenforceable because the plaintiff was forbidden by statute to issue stock as an underwriting commission as the agreement provided. *International Products Co. v. Vail’s Estate*, 97 Vt. 318, 123 Atl. 194. See 8 Minnesota Law Review 618; 14 C. J. 553; *Machen, Corporations*, § 97, 416, 417; *In re Licensed Victualler’s Mut. Trading Ass’n*, [1889] L. R. 42 Ch. Div. 1, 60, L.T.N.S. 684, 58 L.J.Ch.N.S. 467, 37 W.R. 674; 1 *Fletcher, Corporations*, sec. 442. The legal consequences of an underwriting agreement and of a stock subscription are substantially different. *Electric Welding Co. v. Prince*, 195 Mass. 242, 254, 81 N.E. 306, 310; *In re The Bullfontein, etc., Mines*, [1897] 13 T.L.R. 156. Yet there may be difficulty in determining the nature of the agreement in the particular case. 1 *Fletcher, Corporations*, sec. 444. The term “underwriting” is sometimes

executory contract to subscribe in the future, in the event that shares remain undisposed of. Similar agreements are frequently made in regard to bond issues.

§ 33. Subscriptions before incorporation.—A subscription for stock in a corporation to be subsequently formed is differently regarded by different courts. A majority regard it as in effect a continuing offer to the corporation which may be revoked before the corporation is formed and accepts it. Other courts regard it as a binding and irrevocable contract between the subscribers for the benefit of the corporation to be formed, which has the option of accepting or rejecting the subscribers as stockholders. Any recognition by it of the subscriber as a stockholder will make him such.

Subscriptions as an offer to the proposed corporation.—There has been some difficulty in settling the principles governing the effect of subscriptions to the stock of a corporation before its formation. Some of the questions which arise are whether the signature and delivery of a subscription paper bind the subscriber at once, or as soon as the corporation comes into existence, or only after acceptance by the corporation? Is the preliminary agreement a contract by the subscribers with each other? It is now generally held that when persons sign an agreement to form a corporation, and to take stock therein, the subscription of each of the parties is a continuing offer to the proposed corporation, and becomes a binding contract as soon as the corporation is formed, and expressly or implied accepts the same, so that it cannot afterwards be revoked or withdrawn. The fact that the corporation is not in existence at the time the offer is first made by signing the agreement does not prevent the formation of the contract by its acceptance of the offer when formed.¹²

loosely used, and may not be at all indicative of the true agreement. See *Litchfield Sav. Soc. v. Dibble*, 80 Conn. 128, 67 Atl. 476; *Wing v. McCallum*, 244 Fed. 199. The use of this term in this connection is relatively recent, and what was really an underwriting agreement was treated as a valid conditional subscription of stock in *Burke v. Smith*, 16 Wall. (U. S.) 390, 21 L. Ed. 361. Underwriting, see *Machen, Corporations*, chap. VII, secs. 416, 222;

Financing Corporate Enterprises, C. B. Masslich, 5 Illinois Law Review, 70, 76-78; *Gerstenberg, Financial Organization and Management*, chap. XXII, p. 347, *Syndicate Underwriting*; *Wing v. McCallum*, 16 Fed. (2d) 645; *Pole's Case*, [1920] 1 Ch. 582.

¹² *Athol Music Hall Co. v. Carey*, 116 Mass. 471; *Bryant's Pond Steam Mill Co. v. Felt*, 87 Me. 234, 32 Atl. 888, 38 L. R. A. 593, 47 Am. St. Rep. 323.

If one agrees with other subscribers to become a shareholder, two questions may arise: (1) Is it a binding contract upon signature; (2) when does it operate to make the subscriber a shareholder with the rights and corresponding liabilities of one in that relation? The agreement of individuals to form a corporation and to become stockholders to certain amounts, or to take stock in a corporation to be formed by others would seem properly to be regarded as a binding contract. Such subscription papers may fairly be interpreted as constituting an agreement among the subscribers to form a corporation mutually binding and irrevocable, a contract for the benefit of the corporation and enforceable by it when it is brought into existence at its option, but leaving it free to reject any subscription.

In many states the courts do not construe the ordinary subscription as a contract between the subscribers. Under this view, a subscription to stock cannot constitute a binding contract with the corporation before it is formed, for, in the first place, two parties are necessary to a contract, and, in the second place, until the corporation is formed, and expressly or impliedly accepts the subscription, there is no consideration or mutual assent.¹³ By the weight of authority, therefore, a subscriber for stock in a corporation to be afterwards formed may revoke his subscription, and thus prevent a contract with the corporation, at any time before the corporation is formed and the offer accepted.¹⁴ Or the subscription may lapse by reason of the death or insanity of the subscriber before the corporation is formed.¹⁵ The fact that other subscribers have acted upon the strength of a subscription does not prevent its withdrawal before the corporation is formed and accepts

¹³ *Hudson Real Estate Co. v. Tower*, 156 Mass. 82, 30 N. E. 465, 32 Am. St. Rep. 434; *Muncy Traction Engine Co. v. Green*, 143 Pa. St. 269, 13 Atl. 747; *Starrett v. Rockland Fire & Marine Ins. Co.*, 65 Me. 374.

¹⁴ *Hudson Real Estate Co. v. Tower*, 156 Mass. 82, 30 N. E. 465, 32 Am. St. Rep. 434; s. c., 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379; *Bryant's Pond Steam Mill Co. v. Felt*, 87 Me. 234, 32 Atl. 888, 33 L. R. A. 593, 47 Am. St. Rep. 323; *Wallace v. Townsend*, 43 Ohio St.

537, 3 N. E. 601, 54 Am. Rep. 829; *Auburn Bolt & Nut Works v. Shultz*, 143 Pa. St. 256, 22 Atl. 904; *Muncy Traction Engine Co. v. Green*, 143 Pa. St. 269, 13 Atl. 747; *Great Western Tel. Co. v. Loewenthal*, 154 Ill. 261, 40 N. E. 318.

¹⁵ *Pratt v. Trustees of Baptist Soc. of Elgin*, 93 Ill. 475, 34 Am. Rep. 187; *Sedalia, W. & S. Ry. Co. v. Wilkerson*, 83 Mo. 235; *Wallace v. Townsend*, 43 Ohio St. 537, 3 N. E. 601, 54 Am. Rep. 829; *Hudson Real Estate Co. v. Tower*, 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379.

the same.¹⁶ Nor is a revocation prevented, where the corporation has not been formed, by the fact that the subscription is under seal.¹⁷

Of course, the general rule that revocation or withdrawal of an offer does not take effect, so as to prevent an acceptance thereof which will change it into a binding contract, until it is communicated to the person to whom the offer was made, necessarily applies to subscriptions for stock in a corporation. Until notice of its revocation or withdrawal is given, a subscription remains open for acceptance by the corporation.¹⁸ Notice of revocation or withdrawal need not be given to all the other subscribers. It is sufficient if it be given to the corporation, if in existence, or, if it is not, to the person who acted as promoter or agent in receiving it. A subscription to stock in a corporation may be withdrawn before its organization by notification of such withdrawal to another subscriber, who is acting as a member of the committee of subscribers appointed to manage their business, and who has been chosen their president.¹⁹

A subscription paper as a contract between the subscribers.—It has been held by some courts, when a number of persons sign a subscription paper by which they agree to take shares in a corporation to be subsequently formed by them, there is a contract between the subscribers to take stock on condition that the corporation accepts the subscription, which cannot be revoked.²⁰ The mutual promises constitute a sufficient consideration. On this view the subscription is binding from the date of signature or delivery of the written instrument as an irrevocable offer to the corporation which by its assent may make the subscriber a stockholder in ac-

¹⁶ *Hudson Real Estate Co. v. Tower*, 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379; s. c., 156 Mass. 82, 30 N. E. 465, 32 Am. St. Rep. 434.

¹⁷ *Hudson Real Estate Co. v. Tower*, 156 Mass. 82, 30 N. E. 465, 32 Am. St. Rep. 434; s. c., 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379.

¹⁸ *Hudson Real Estate Co. v. Tower*, 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379.

¹⁹ *Hudson Real Estate Co. v. Tower*, 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379. See also, *Muncy Traction Engine Co. v. Green*, 143 Pa. St. 269, 13 Atl. 747.

²⁰ *Shelby County R. Co. v. Crow*, 137 Mo. App. 461, 119 S. W. 435; *Minneapolis Threshing Mach. Co. v. Davis*, 40 Minn. 110, 41 N. W. 1026, 3 L. R. A. 796, 12 Am. St. Rep. 701; *Tonica & P. R. Co. v. McNeely*, 21 Ill. 71; *Marysville Elec. Light & Power Co. v. Johnson*, 93 Cal. 538, 29 Pac. 126, 27 Am. St. Rep. 215; *International Fair & Exposition Ass'n v. Walker*, 83 Mich. 386, 47 N. W. 338; *Edinboro's Academy v. Robinson*, 37 Pa. St. 210, 78 Am. Dec. 421. See *M. O. Hudson*, 9 Missouri Law Bulletin, Law Series, p. 3, 10, 33; 8 Columbia Law Rev. 47.

cordance with his agreement.²¹ On the theory that the other subscribers are parties to the contract as well as the corporation, it seems contrary to elementary principles of contract law to permit one who has by subscribing the preliminary paper, induced the subscriptions of his associates, to revoke his subscription and escape from the responsibilities which he has agreed to assume.

A majority of courts, however, apparently holds that when a number of persons sign a subscription paper agreeing to take stock in a corporation to be formed, expressly or impliedly agreeing to pay the amount of their subscriptions to the corporation when formed, they do not intend a contract with each other, but intend to contract with the corporation when formed. The agreement is so construed even where it recites that it is "to and with each other."²² Whether there is such a contract depends upon the intention of the parties. Of course, it is possible for persons to enter into a contract with each other individually to form a corporation and take stock therein, and if such an intention appears the courts must construe the contract accordingly.²³ Ordinarily, however, the parties signing a subscription paper do not intend to contract with each other individually, but intend to contract with the corporation when formed. When this is the intention, the agreement must be so construed,—not as a case of mutual promises, but as so many separate continuing offers to the proposed corporation, which must be expressly or impliedly accepted by the corporation before any contract can result.²⁴

In a Minnesota case it was held that, where a number of persons sign a subscription paper agreeing to take stock in a corporation to be thereafter formed by them, there is (1) a contract between the subscribers themselves to become stockholders, without further act on their part, immediately upon the formation of the corpora-

²¹ *Wolf v. Excelsior Automatic Scale & Supply Co.*, 270 Pa. 547, 113 Atl. 569; *Farm Lands Development Co. v. Taft*, 186 Iowa 481; 186 N. W. 431; *Shelby Co. R. Co. v. Crow*, 137 Mo. App. 461, 119 S. W. 435; *De Giverville Land Co. v. Thompson*, 190 Mo. App. 682, 176 S. W. 409; *Marysville Light & Power Co. v. Johnson*, 93 Cal. 538, 29 Pac. 126, 27 Am. St. Rep. 215; *Peek v. Steinberg*, 163 Cal. 127, 124 Pac. 834.

²² *Athol Music Hall Co. v. Carey*, 116 Mass. 471. See *Bryant's Pond*

Steam Mill Co. v. Felt, 87 Me. 234, 32 Atl. 888, 33 L. R. A. 593; 47 Am. St. Rep. 323; *Planters' & Merchants' Independent Packet Co. v. Webb*, 156 Ala. 551, 46 So. 977, 16 Ann. Cas. 529.

²³ See *Lake Ontario Shore R. Co. v. Curtiss*, 80 N. Y. 219.

²⁴ See *Phillips Limerick Academy v. Davis*, 11 Mass. 113, 6 Am. Dec. 162; *Athol Music Hall Co. v. Carey*, 116 Mass. 471; *Bryant's Pond Steam Mill Co. v. Felt*, 87 Me. 234, 32 Atl. 888, 33 L. R. A. 593, 47 Am. St. Rep. 323.

tion, binding and irrevocable from the date of the subscription, unless canceled by consent of all the subscribers before acceptance by the corporation; and (2) a continuing offer to the proposed corporation, which, upon acceptance by it after its formation, becomes as to each subscriber a contract between him and the corporation. The promoter of the proposed corporation soliciting and obtaining subscriptions is the agent of the subscribers as a body to hold the subscriptions until the corporation is formed in accordance with the terms and conditions of the agreement, and then turn them over to it without any further act of delivery on the part of the subscribers, and therefore a delivery of the subscription to him is a complete delivery, so as to make it *eo instanti* a binding and irrevocable contract.²⁵

If a subscription paper be regarded as constituting both a contract between the subscribers as individuals and a continuing offer to the proposed corporation, a breach by one of the signers by withdrawing before formation of the corporation might be held merely to give the others, as individuals, a right of action for any damages sustained by them. But it may well be held that, even after such a breach, his offer would continue so as to be open for acceptance by the corporation when formed, as in the case of an option.²⁶

Subscriptions irrevocable by force of charter or statute.—It is undoubtedly within the power of the legislature to make subscriptions binding and irrevocable before the corporation is formed or accepts the same. And it has been held, therefore, in several states, that the rule that a subscription to the stock of a corporation to be formed is not binding, and may be revoked by the subscriber at any time before the corporation is formed and accepts the same, does not apply to subscriptions made as a step authorized or required by a charter or general law in the formation of a corporation as where one signs the certificate or incorporation paper. Such a subscription, according to these decisions, although it cannot be regarded in any sense as a contract between the corporation and the subscriber, until the corporation is organized, is nevertheless binding upon the subscriber from the time it is made, by force of the statute, and cannot be withdrawn.²⁷

²⁵ Minneapolis Threshing Mach. Co. v. Davis, 40 Minn. 110, 41 N. W. 1026, 12 Am. St. Rep. 701. See Clapp v. Gilt Edge Consol. Mines Co., 33 S. Dak. 123, 144 N. W. 721.
²⁶ Minneapolis Threshing Mach.

Co. v. Davis, 40 Minn. 110, 41 N. W. 1026, 12 Am. St. Rep. 701. See Pole's Case, [1920] 1 Ch. 582.

²⁷ Dorris v. French, 4 Hun 292; Buffalo & N. Y. C. R. Co. v. Dudley, 14 N. Y. 336; Lake Ontario, A. &

Necessity of assent by corporation.—One may sign a subscription list and agree to take shares of stock in a corporation to be formed, but until the corporation is brought into existence the agreement is simply among the subscribers, if it amounts to a contract at all. Upon assent by the corporation the agreement between corporation and subscriber establishes the relation of shareholder. Assent by the corporation need not be expressed in any particular form. If the agreement were one of purchase a tender of delivery of the certificates might be necessary to the enforcement of the contract.

A subscription for stock need not be accepted by the corporation in any particular way, unless this is required by the charter or statute, or expressly or impliedly by the subscription itself, but may be inferred from the conduct of the corporation in entering it in its books, retaining it, demanding payment, or otherwise acting upon it; and notice of acceptance is not necessary,²⁸ unless such notice is required by the terms of the subscription.²⁹

In England, where a formal written application for shares is made by persons desiring to take shares, the application is a mere offer, which must be accepted before either the applicant or the company is bound. Until the company accepts the offer and allots the shares to the applicant, and gives him notice of the acceptance and allotment, there is no contract, and neither party is bound.³⁰

N. Y. R. Co. v. Mason, 16 N. Y. 451; *Johnson v. Wabash & Mt. V. Plank-Road Co.*, 16 Ind. 389; *Coppage v. Hutton*, 124 Ind. 401, 24 N. E. 112, 7 L. R. A. 591; *Greenbrier Industrial Exposition v. Rodes*, 37 W. Va. 738, 17 S. E. 305; *Rehbein v. Rahr*, 109 Wis. 136, 85 N. W. 315.

²⁸ *Hawley v. Upton*, 102 U. S. 314, 26 L. Ed. 179. Hawley by his bond to an insurance company promised to pay \$200 in instalments for ten shares of stock. The bond was delivered to the company which entered his name on their books as a stockholder and published him as such in their publications, Hawley having no knowledge of this. Apparently this was a sufficient acceptance, although not communicated to him. See 14 C. J. 515; *New Albany & S. R. Co. v. McCormick*, 10 Ind. 499, 71 Am. Dec. 337. Compare *Cozart v. Herndon*, 114 N. C. 252, 19 S. E. 158.

It might be contended that a subscription paper is in reality an agreement by the subscribers to form a corporation and contribute to it in certain proportions. They authorize the steps to be taken to comply with the statutory formalities, and therefore may well be regarded as becoming at once stockholders upon such compliance without further acceptance. There seems to be no need of a power of rejection of subscriptions to protect the interests of the corporation. See *Bole v. Fulton*, 233 Pa. 609, 82 Atl. 947.

²⁹ *Cozart v. Herndon*, 114 N. C. 252, 19 S. E. 158. See 2 *Fletcher, Corporations*, secs. 522, 523.

³⁰ *In re Brewery Assets Corporation* [1894] 3 Ch. 272; *Ramsgate Victoria Hotel Co. v. Montefiore*, L. R. 1 Exch. 109; *Hebb's Case*, L. R. 4 Eq. 9; *Harris' Case*, 7 Ch. App. 587; *Household Fire & Carriage Accident Ins. Co. v. Grant*, 4 Exch. Div. 216.

The mailing of notice properly addressed is essential, though it will operate even if lost in the mail. An unexpressed or undeclared acceptance is not enough. The shares must be allotted by the directors, and notice thereof given to the applicant, or put in a way to be communicated to him as contemplated by the application.³¹

In a Maryland case³² it is said that subscribers to stock before the creation of the body corporate became stockholders by the mere act of subscribing, for the purpose of effecting an organization. They acquire by such subscription an interest in the body corporate and a right to participate in its organization. This would seem to be erroneous. It is believed that there is no legal right in one who has merely signed a subscription paper to vote or take part in a stockholders' meeting until his subscription is accepted, unless he is considered to become such *ipso facto* on incorporation without option to the corporation to accept or reject. A stockholders' meeting could not strictly be held before the acceptance of the subscriptions and this would naturally have to be made either by the directors appointed in the articles for the first year, or by the incorporators, i. e., those who have signed the incorporation paper and to whom the corporate privilege is granted in the first instance until shareholders are created by acceptance of subscriptions.³³ Until stock is subscribed the incorporators are vested with all the corporate powers, at least as to organization.

In *Badger Paper Co. v. Rose*,³⁴ the plaintiff corporation sought to hold subscribers to stock in a newspaper company for goods sold and delivered to the corporation. The suit was brought under a

See *Morse, etc., Co. v. Coates*, 38 Dom. Law Rep. (Can.) 92; In re *Manchester Stores, Ltd.*, 51 Ont. Law Rep. 637.

³¹ *Hebb's Case*, L. R. 4 Eq. 9; *Harris' Case*, 7 Ch. App. 587; *Adams' Case*, L. R. 13 Eq. 474; *Household Fire & Carriage Accident Ins. Co. v. Grant*, 4 Exch. Div. 216.

³² *Baltimore City Passenger Ry. Co. v. Hambleton*, 77 Md. 341, 26 Atl. 279. See also, *St. Paul, S. & T. F. R. Co. v. Robbins*, 23 Minn. 439. See *Bole v. Fulton*, 233 Pa. 609, 82 Atl. 947; *Monterey & S. V. R. Co. v. Hildreth*, 53 Cal. 123.

³³ See *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43, 54; *Chase v. Lord*, 77 N. Y. 1, 11, 6 Abb. N. C. 258. After the incorporators have completed the organization and man-

aged the issuance of shares, their function is performed and their place is taken by the stockholders. *Fletcher, Corporations*, sec. 1757; *Machen, Corporations*, sec. 165; 2 *Nebraska Law Bulletin* No. 4, p. 46. Until stock is subscribed, the incorporators are vested with all the corporate powers, at least as to organization such as electing directors and accepting subscriptions.

³⁴ 95 Wis. 145, 70 N. W. 302, 37 L. R. A. 162. It does not appear by what right they participated in the organization meeting before acceptance of their subscriptions. This case is to be distinguished from subscription to stock in a corporation already organized which offers its unissued stock. The subscription is an acceptance of this offer and

Wisconsin statute by which stockholders were made personally liable for obligations of the corporation which transacts business before one-half of its capital has been subscribed and twenty per cent of it actually paid in. The articles of organization were properly filed on September 5, and the corporation came into existence on that day, and was capable of contracting obligations in its corporate capacity; but it was held that the defendants were not stockholders when the contract was made because the subscription papers had not been presented to the corporation and assented to by it. Subscribers become stockholders only by acceptance. Mere incorporation was insufficient to give them such status. The subscribers, including the defendants, had met on October 6 and the signers of the subscription paper participated in the organization and a manager was chosen. The contract for the paper was made on behalf of the corporation on September 27, 1893, but the paper was used after October 6. The court says that the question was whether the defendants were stockholders at the time the contract was made and the obligation was contracted, viz., on September 27.

§ 34. Agreements to pay to agent or trustee for proposed corporation.

Instead of subscribing directly for stock in a proposed corporation, so as to create a contract between the subscribers and the corporation when formed, a number of persons may enter into a mutual agreement to form a corporation and take stock therein, and to pay the amounts which they agree to subscribe to a certain person as agent or trustee. Such an agreement is a valid contract between the parties, being a case of mutual promises, and their liability to pay is not affected by the fact that they have not subscribed articles of incorporation in compliance with the statute under which the corporation is formed, or by the fact that it has not yet been formed, unless this is required by the contract.³⁵

makes a binding contract. There is no need for acceptance of the acceptance. *Southwestern Slate Co. v. Stephens*, 139 Wis. 616, 120 N. W. 408, 29 L. R. A. (N. S.) 92, 131 Am. St. Rep. 1074.

³⁵ *Horseshoe Pier Amusement Co. v. Sibley*, 157 Cal. 442, 108 Pac. 308. "Plaintiff's right to recover rested upon an express promise to pay, not upon an obligation due to

the relation of stockholder." *West v. Crawford*, 80 Cal. 19, 21 Pac. 1123; *San Joaquin Land & Water Co. v. West*, 94 Cal. 399, 29 Pac. 785. Subscription agreement construed and held to bind subscribers to promoter, who could sue them although they attempted to revoke. See *Missouri Law Bulletin*, 9 Law Series, pp. 3-37.

Under such a contract as this, the agent or trustee, as the trustee of an express trust, may, under the statutes, maintain an action against the subscribers on their several promises, and collect the money for the use of the corporation.³⁶ And when the trustees have collected the money, the corporation, for whose use it has been received, may maintain an action against them to recover the same.³⁷ This is a useful method of drawing subscription papers in jurisdictions where a binding preliminary agreement between the subscribers is not recognized. By the agreement with the trustee each subscriber is bound from the moment of signing, without notice of acceptance by the corporation. After the corporation is formed he becomes its trustee, and not the agent or trustee of the subscribers. The corporation may remove him at any time, and appoint another in his place, or itself bring suit and no formal assignment from the trustee to the corporation is necessary, as the corporation is the real party in interest,³⁸ the beneficiary of the contract.

§ 35. Form and terms of subscription.

Unless the charter of a corporation, or the general law under which it is organized, requires that subscriptions shall be in some particular form, or that they shall be made with certain formalities, no other form or formality is necessary to a valid subscription than is required for any other simple contract.³⁹

The contract, of course, must be sufficiently definite and certain to enable a court to enforce it. It should indicate the nature of the corporation to be formed, the amount of authorized capital stock, the par value, and the number of shares subscribed for.⁴⁰

³⁶ *Horseshoe Pier Amusement Co. v. Sibley*, 157 Cal. 442, 108 Pac. 308; *West v. Crawford*, 80 Cal. 19, 21 Pac. 1123.

³⁷ *San Joaquin Land & Water Co. v. West*, 94 Cal. 399, 29 Pac. 785.

³⁸ *San Joaquin Land & Water Co. v. West*, 94 Cal. 399, 29 Pac. 785; *Horseshoe Pier Amusement Co. v. Sibley*, 157 Cal. 442, 108 Pac. 308; *Drake Hotel Co. v. Crane*, 210 Mo. App. 452, 240 S. W. 859.

³⁹ *Nulton v. Clayton*, 54 Iowa 425, 6 N. W. 685, 37 Am. Rep. 213; *Bridgeport Window Hardware Co. v. Osborne*, 222 Mass. 517, 111 N. E. 364.

⁴⁰ *In Nebraska Chicory Co. v. Lednický*, 79 Neb. 587, 113 N. W. 245,

defendant agreed to take five shares in a corporation to be organized. The Nebraska statute provided for opening of stock books for subscriptions. Defendant did not sign a stock book, for none was opened, but did pay instalments on his subscription. Upon refusal to pay further, the company sued. Held, the defendant was a stockholder and liable for the balance of his subscription. Acceptance made him a shareholder. A subscription is binding though not formally made.

⁴⁰ *Nemaha Coal & Mining Co. v. Little*, 54 Kan. 424, 38 Pac. 483. Subscription paper did not specify total amount of capitalization, or when and by whom the corporation

To render one liable as a subscriber for stock in a corporation by reason of his having signed a subscription paper or articles of association, the paper must be complete. "A signature to an incomplete paper, wanting in any substantial particular, when no delegation of authority is conferred to supply the defect, does not bind the signer, without further assent on his part, to the completion of the instrument."⁴¹

Necessity for writing—Statute of frauds.—No writing at all is necessary to a valid subscription to the stock of a corporation unless it is expressly or impliedly required by the charter or the general law under which the corporation is formed. In the absence of such a requirement, a valid subscription may be made either orally or in writing, or partly orally and partly in writing.⁴² A subscription for stock in a corporation is not within the statute of frauds, either as an agreement for the sale of goods, wares, or merchandise, or, when the corporation owns land, as an agreement for the sale of land, or an interest therein.⁴³

Statutes sometimes require payment by a subscriber for stock of a certain per cent on each share at the time of his subscription. These statutes are intended to provide a fund for creditors. Some courts hold that such payment is a condition precedent to the validity of the subscription. The majority, however, hold otherwise, especially where the subscriber seeks to evade liability after he has acted as a stockholder and received the full benefit of the subscription, and the corporation is insolvent.⁴⁴

was to be organized. *Woods Motor Vehicle Co. of Buffalo v. Brady*, 181 N. Y. 145, 73 N. E. 674. See *Jamestown Portland Cement Corp. v. Bowles*, 228 Mass. 176, 117 N. E. 41; *Rutenbeck v. Hohn*, 143 Iowa 13, 121 N. W. 698, 136 Am. St. Rep. 731.

⁴¹ *Dutchess & Columbia County R. Co. v. Mabbett*, 58 N. Y. 397; *Nemaha Coal & Mining Co. v. Settle*, 54 Kan. 424, 38 Pac. 483.

⁴² *Vermont Marble Co. v. Deelee Granite Co.*, 135 Cal. 579, 67 Pac. 1057, 56 L. R. A. 728, 87 Am. St. Rep. 143; *Rutenbeck v. Hohn*, 143 Iowa 13, 121 N. W. 698, 136 Am. St. Rep. 731; *Colfax Hotel Co. v. Lyon*, 69 Iowa 683, 29 N. W. 780; *Bullock v. Falmouth & C. H. Turnpike Road Co.*, 85 Ky. 184, 3 S. W. 943; *Shellenberger v. Patterson*, 168 Pa. St. 30, 31 Atl. 943; *Webb v. Baltimore & E. S. R. Co.*, 77 Md. 92, 26 Atl.

113, 39 Am. St. Rep. 396. See *Spencer v. McGuffin*, 190 Ind. 308, 130 N. E. 407, 14 A. L. R. 385, 400; *Mills v. Friedman*, 111 N. Y. Misc. 253, 181 N. Y. Supp. 285.

⁴³ *Webb v. Baltimore & E. S. R. Co.*, 77 Md. 92, 26 Atl. 113, 39 Am. St. Rep. 396; *York Park Bldg. Ass'n v. Barnes*, 39 Neb. 834, 58 N. W. 440; *Rogers v. Burr*, 105 Ga. 432, 31 S. E. 438, 70 Am. St. Rep. 50; *Peninsula Leasing Co. v. Cody*, 161 Mich. 604, 126 N. W. 1053. See *Spencer v. McGuffin*, 190 Ind. 308, 130 N. E. 407, 14 A. L. R. 385, 400.

⁴⁴ *Jeffrey v. Selwyn*, 220 N. Y. 77, 115 N. E. 275, 6 A. L. R. 1111n. Effect on the validity of subscription to corporate stock of failure to comply with statutory requirement of payment at the time of subscribing of a per cent of his subscription.

§ 36. Formation of a different corporation or with different powers than agreed.

A person who subscribes for stock in a corporation to be formed, and who does not consent to any change in the subscription, is not liable if the corporation which is afterwards formed, and which seeks to enforce the subscription, is a different corporation from that contemplated by the subscription.⁴⁵ The principle applies where the corporation, although formed under the law under which it was intended to be formed, is formed for other purposes or with other powers than those contemplated by the subscribers, so that a different enterprise is authorized than that contemplated by the subscription. A subscription to a corporation to be formed for the purpose of "furnishing the incandescence system of electric lighting," cannot be enforced by a corporation formed for the purpose of "producing electricity and power." The subscriber could not be compelled to contribute money for stock in a corporation for an additional and distinct purpose or branch of business.⁴⁶ It has been held, however, that if the powers and purposes expressed in the articles are properly incidental to the accomplishment of the main purpose or object set out in the subscription agreement the subscriber will not be released even if the articles mention powers or purposes not specifically included, as the subscriber impliedly consents to whatever is reasonably necessary and incidental.⁴⁷

Effect of defective incorporation.—If a person subscribes for stock in a corporation after its organization and assumption of corporate powers, it is sufficient to show a *de facto* corporate existence to support an action on the subscription. The action cannot be defeated by showing that there have been such irregularities in the organization of the corporation that there is not a corporation *de jure*.⁴⁸ Further than this, although there may not be even a

⁴⁵ *Collings v. Allen*, 90 N. J. Law 5, 100 Atl. 170; *Dorris v. Sweeney*, 60 N. Y. 463; *Norwich Lock Mfg. Co. v. Hoekaday*, 89 Va. 557, 16 S. E. 877; *Marysville Electric Light & Power Co. v. Johnson*, 109 Cal. 192, 41 Pac. 1016, 50 Am. St. Rep. 34.

⁴⁶ *Marysville Electric Light & Power Co. v. Johnson*, 109 Cal. 192, 41 Pac. 1016, 50 Am. St. Rep. 34. Compare *Midland City Hotel Co. v. Gibson*, 11 Ga. App. 829, 76 S. E. 600; *Tri-State Fair Ass'n v. Lasell*, 45 S. D. 414, 187 N. W. 824. The objection to change of purpose may

be waived. *Walter v. Merced Academy Ass'n*, 126 Cal. 582, 59 Pac. 136. See *Smith v. Burns Boiler & Mfg. Co.*, 132 Wis. 177, 111 N. W. 1123.

⁴⁷ *National Bank of Union Point v. Amoss*, 144 Ga. 425, 87 S. E. 406; *Tri-State Fair Ass'n v. Lasell*, 45 S. D. 414, 187 N. W. 824.

⁴⁸ *Heaston v. Cincinnati & Ft. W. R. Co.*, 16 Ind. 275, 79 Am. Dec. 430; *Eaton v. Aspinwall*, 19 N. Y. 119; *Buffalo & A. R. Co. v. Cary*, 26 N. Y. 75.

corporation *de facto*, a subscription may be enforceable by reason of the doctrine of estoppel. As we have seen, it is a general rule, recognized in most jurisdictions, although not in all, that a person who enters into a contract with an association as a corporation thereby admits its corporate existence, and is estopped to deny the same, whether it be a corporation *de facto* or not, in any action or proceeding based upon or arising out of the contract.⁴⁹

The principles above stated do not apply when a subscription for stock is made prior to the formation of a corporation, and in contemplation thereof. In such a case, it is a condition precedent to any liability upon the subscription, implied if not expressed, that the corporation shall be legally organized as contemplated; and the subscriber, therefore, may defeat an action on his subscription, unless estopped, by showing that the condition has not been performed. There must be, in the absence of an estoppel, not merely a corporation *de facto*, but a corporation *de jure*.⁵⁰ A subscriber for stock, whether after or before formation of the corporation, is estopped to deny the legality of its organization or its corporate existence, both as against creditors and as against the corporation itself, if he participated in its organization, or acquiesced therein with knowledge of the facts, or if he has recognized it as being legally organized, or if he has acted as an officer or stockholder or otherwise participated in holding it out to the public as a legally constituted corporation.⁵¹

II. SUBSCRIPTIONS UPON EXPRESS CONDITIONS PRECEDENT; IMPLIED CONDITIONS PRECEDENT; AND CONDITIONAL DELIVERY OF SUBSCRIPTIONS.

§ 37. In general.—A subscription upon a condition precedent, or conditional subscription, is a subscription which, while it takes effect as a contract, and is irrevocable, as soon as it is accepted, does not make the subscriber a stockholder, or subject him to any

⁴⁹ As to this doctrine, and the conflict of authority on particular points, see ante, § 27.

⁵⁰ *Indianapolis Furnace & Mining Co. v. Herkimer*, 46 Ind. 142; *Dorris v. Sweeney*, 60 N. Y. 463; *Capps v. Hastings Prospecting Co.*, 40 Neb. 470, 58 N. W. 956, 24 L. R. A. 259, 42 Am. St. Rep. 677; *Schloss v. Montgomery Trade Co.*, 87 Ala. 414, 6 So. 360, 13 Am. St. Rep. 51. See ante, § 26.

⁵¹ *Chester Glass Co. v. Dewey*, 16 Mass. 94, 8 Am. Dec. 128; *Minnesota Gas-Light Economizer Co. v. Denslow*, 46 Minn. 171, 48 N. W. 771; *Jones v. Dodge*, 97 Ark. 248, 133 S. W. 828, L. R. A. 1915 A 472, 475n; on right to defeat stock subscription or stockholders' liability on the ground that the corporation is not legally organized.

liability, until performance of some condition, express or implied, unless the condition is waived by the subscriber, or he is estopped by his conduct to set up its nonperformance.

Subscription upon a condition precedent.—Subscriptions for shares are frequently made subject to certain conditions, and it may be a matter of some difficulty to determine how the condition is intended to operate. Thus in *McMillan v. Maysville & C. R. Co.*,⁵² the defendant signed a subscription paper by which he and others agreed to take stock in a railroad company, "upon condition that said road shall be so located and constructed as to make the town of Carlisle a point on said road; otherwise these subscriptions shall be null and void." It was held that the subscribers became unconditional stockholders when the road was so "located," but that the subscription and the obligation to pay were not conditional upon actual construction.

Conditional subscriptions, or subscriptions upon conditions precedent, must be distinguished from subscriptions upon special terms. A conditional subscription, as we have seen, does not make the subscriber a stockholder, or render him liable to pay the amount of the subscription, until performance or fulfillment of the condition.⁵³ A subscription upon special terms, on the other hand, is an absolute subscription, making the subscriber a stockholder, and rendering him liable as such, as soon as it is accepted; the special term being an independent stipulation, for a breach of which the subscriber's remedy is against the corporation for damages. In case of doubt as to the intention of the parties, a subscription should be construed as an absolute subscription upon special terms, rather than as conditional.⁵⁴ If it appears from the language of the subscription, or from extraneous circumstances, that it was intended that the subscriber should become and act as a stock-

⁵² *McMillan v. Maysville & L. R. Co.*, 15 B. Mon. (Ky.) 218, 61 Am. Dec. 181; *Red Wing Hotel Co. v. Friedrich*, 26 Minn. 112, 1 N. W. 827; *Webb v. Baltimore & E. S. R. Co.*, 77 Md. 92, 26 Atl. 113, 39 Am. St. Rep. 396; *Cravens v. Eagle Cotton Mills Co.*, 120 Ind. 6, 21 N. E. 984, 16 Am. St. Rep. 298.

⁵³ In *Farm Lands Development Co. v. Taft*, 194 Iowa 481, 186 N. W. 431, it is said that a conditional subscription is a continuing offer. But it is an offer to the corporation which cannot be withdrawn or re-

voked because it is contained in a contract between the several subscribers. A conditional offer to subscribe may of course be made which may be revoked before the specified conditions are performed, unless the corporation is in the course of performance. *Webb v. Baltimore & E. S. R. Co.*, 77 Md. 92, 26 Atl. 113, 39 Am. St. Rep. 396.

⁵⁴ *Paducah & M. R. Co. v. Parks*, 86 Tenn. 554, 8 S. W. 842; *Morrow v. Nashville Iron & Steel Co.*, 87 Tenn. 262, 10 S. W. 495, 3 L. R. A. 37, 10 Am. St. Rep. 658.

holder prior to the performance of the stipulations contained in the contract, they are clearly special terms, and not conditions precedent, for a subscriber does not become a stockholder until conditions precedent are performed.⁵⁵ The same is true when it appears that the corporation was expected to expend money, which must be paid by the subscribers, before performance of the stipulation.

In *Red Wing Hotel Co. v. Friedrich*,⁵⁶ the subscription agreement to the Hotel Company provided that this subscription is expressly upon the condition that the hotel to be built by said corporation shall be "built and located upon the southeast corner of Block 44." The subscription was accepted at the first meeting of the board of directors. It was held that the defendant's subscription took effect at the time of acceptance by the company and that the building of the hotel was not a condition precedent to the right of the company to call for payment of the stock. The words were words of present agreement; the hotel was to be built with the stock subscriptions and the payments were necessary to enable the company to carry forward the undertaking.

A subscription may be made upon condition that the whole or a certain percentage of the capital stock shall be subscribed, or shall be subscribed by persons in a certain locality or of a certain class.⁵⁷ Indeed, as we shall see, a condition that the full amount of the capital stock shall be subscribed is implied unless there is something in the contract of subscription, or in the charter, enabling act, or articles of association, to show an intention to the contrary.

§ 38. Validity of conditions precedent.

Conditional subscriptions to the stock of a corporation are valid, provided there is nothing in the charter or enabling act to prohibit them, and provided the conditions are not such as to render their performance beyond the powers of the corporation, or in violation of law, or contrary to public policy.⁵⁸

⁵⁵ *Morrow v. Nashville Iron & Steel Co.*, 87 Tenn. 262, 10 S. W. 495, 3 L. R. A. 37, 10 Am. St. Rep. 658, 669; *Lane v. Brainerd*, 30 Conn. 565; *Johnson v. Georgia Midland & G. R. Co.*, 81 Ga. 725, 8 S. E. 531.

⁵⁶ 26 Minn. 112, 1 N. W. 827; *Connecticut & P. R. R. Co. v. Bailey*, 24 Vt. 465, 58 Am. Dec. 181.

⁵⁷ *Cravens v. Eagle Cotton Mills Co.*, 120 Ind. 6, 21 N. E. 984, 16 Am. St. Rep. 298; *Brand v. Lawrenceville Branch R. R.*, 77 Ga. 506, 1 S.

E. 255; *People's Ferry Co. v. Balch*, 8 Gray (Mass.) 303; *New York Exchange Co. v. De Wolf*, 31 N. Y. 273; *Union Hotel Co. v. Hersee*, 79 N. Y. 454, 35 Am. Rep. 536, rev'g 15 Hun 371.

⁵⁸ *McMillan v. Maysville & L. R. Co.*, 15 B. Mon. (Ky.) 218, 61 Am. Dec. 181; *Taggart v. Western Maryland R. Co.*, 24 Md. 563, 89 Am. Dec. 760; *Baltimore & D. P. R. Co. v. Pumphrey*, 74 Md. 86, 21 Atl. 559; *Cravens v. Eagle Cotton Mills Co.*,

Oral conditions.—Whether or not oral conditions can be shown to qualify or affect a subscription in writing which is absolute on its face must be determined by the application of the general principles with respect to the admission of parol evidence to vary or add to the terms of a written contract. As to these principles, there is some difference of opinion. According to the weight of authority, parol evidence is not admissible to import conditions into a written contract which is absolute and complete on its face, unless failure to express the conditions was due to fraud or mistake; and this doctrine has been applied where it has been attempted to show by parol evidence that a written subscription to the stock of a corporation absolute on its face was in fact made upon conditions.⁵⁹

A secret agreement for the release or reduction of the liability of an ostensible subscriber is generally held no defense to the subscriber when sued upon his subscription. Such secret agreements are void as being fraudulent toward other subscribers or to creditors.⁶⁰

§ 39. Conditional delivery of subscriptions.—By the weight of authority, a written subscription, absolute and complete on its face, may be conditionally delivered even to the officers, agents

120 Ind. 6, 21 N. E. 984, 16 Am. St. Rep. 298; Union Hotel Co. v. Hersee, 79 N. Y. 454, 35 Am. Rep. 536, rev'g 15 Hun 371; Armstrong v. Karshner, 47 Ohio St. 276, 24 N. E. 897.

⁵⁹ Collins v. Southern Brick Co., 92 Ark. 504, 123 S. W. 652, 135 Am. St. Rep. 197, 19 Ann. Cas. 882; Ozark States Trust Co. v. Winkler, 84 Okla. 116, 202 Pac. 12; Masonic Temple Ass'n of Minneapolis v. Channell, 43 Minn. 353, 45 N. W. 716; Anderson v. Middle & East Tennessee Cent. R. Co., 91 Tenn. 44, 17 S. W. 803; Braddock v. Philadelphia M. & M. R. Co., 45 N. J. Law 363; Bergman v. Evans, 92 Wash. 158, 158 Pac. 961, Ann. Cas. 1918 C 848.

In Pennsylvania the doctrine with respect to the admissibility of parol evidence is not the same as in other states. It is there held that, if the subscription would not have been made except for the oral condition, it may be proved, provided the rights of creditors are not involved, since to allow the corporation to enforce the subscription would oper-

ate as a fraud. See *McCarty v. Selinsgrove & N. B. R. Co.*, 87 Pa. St. 332; *Miller v. Hanover Junction & S. R. Co.*, 87 Pa. St. 95, 30 Am. Rep. 349; *Rinesmith v. People's Freight Ry. Co.*, 90 Pa. St. 262. Compare *McClure v. People's Freight Ry. Co.*, 90 Pa. St. 269; *Kramer v. Hamsher*, 63 Pa. Super. Ct. 211.

⁶⁰ Secret agreement limiting subscription invalid if unfair to other stockholders or creditors. *Bridgeport Window Hardware Co. v. Osborne*, 222 Mass. 517, 111 N. E. 364; *Quartz Glass Co. v. Joyce*, 27 Cal. App. 523, 150 Pac. 648; *Sarbach v. Kansas Fiscal Agency*, 86 Kan. 734, 122 Pac. 113, Ann. Cas. 1913 C 415; *White Mountains R. R. v. Eastman*, 34 N. H. 124; *Boushall v. Stronach*, 172 N. C. 273, 90 S. E. 198. A secret contemporaneous agreement that one shall not be required to pay his subscription cannot be shown under the parol evidence rule against varying the contract. It is also fraudulent against other stockholders and creditors.

or promoters of the corporation, on the understanding that it shall not take effect until the performance of an oral condition precedent. But the apparent subscriber may be estopped to set up the oral condition precedent against parties misled.

It is a settled principle in most jurisdictions that it may be shown that a written agreement, such as a contract of subscription, was delivered with the understanding that it should not take effect until the performance or fulfillment of an oral condition, even though the delivery may have been to an agent or even a director of the corporation, the evidence being admitted in such a case, not for the purpose of adding a condition to the contract or agreement, but for the purpose of showing that as yet there has been no contract or agreement at all.⁶¹ This doctrine, however, is to be applied in "cases strictly between the original parties, and where no one has changed his situation in reliance upon the contract and in ignorance of the secret oral condition attached to the delivery."⁶² Where a person signs and delivers a subscription paper to a promoter upon an oral condition, and other persons subscribe and pay without notice of the oral condition, and the corporation is organized in reliance on the subscriptions and incurs liabilities, the subscriber cannot show the secret oral condition to escape from his obligation as a subscriber.

In *Minneapolis Threshing Mach. Co. v. Davis*,⁶³ the defendant subscribed for \$5,000 of stock in a corporation to be formed with

⁶¹ *City Nat. Bank of Auburn, Ind. v. Mason*, 192 Iowa 1048, 186 N. W. 30; *Pym v. Campbell*, 6 El. & Bl. 370; *Cass v. Pittsburg, V. & C. Ry. Co.*, 80 Pa. St. 31; *Gilman v. Gross*, 97 Wis. 224, 72 N. W. 885; *Westman v. Krumweide*, 30 Minn. 313, 15 N. W. 255; *Davis v. Kneale*, 97 Mich. 72, 56 N. W. 220; *Benton v. Martin*, 52 N. Y. 570.

On delivery in escrow and the parol evidence rule, see *Ballantine*, 29 *Yale Law Journal* 826; 5 *Minn. Law Rev.* 287. The doctrine as to conditional delivery is really an exception to the parol evidence rule. "The distinction between proving by parol that the delivery of a contract was conditional, and that the contract itself contained a condition not expressed in the writing is one founded more on refinement than upon sound, practical grounds."

⁶² In *Cook v. Chittenden*, 25 Fed. 544, the defendant agreed in writing to take 50 shares of stock in an insurance company, subject to an oral condition or understanding with the agent that he might withdraw his subscription at any time before the agent of the company left the city. He elected to withdraw and the agent assented, but his name was put on the stock book of the company. Twelve years later, after the Chicago fire, the assignee in bankruptcy sues to recover an assessment upon the capital stock. It was held that the defendant was not liable as he was released before he was ever held out as a stockholder.

⁶³ 40 *Minn.* 110, 41 N. W. 1026, 3 L. R. A. 796, 12 *Am. St. Rep.* 701. And see *Benton v. Martin*, 52 N. Y. 570; *Sweet v. Stevens*, 7 R. I. 375.

\$250,000 capital. He delivered his signature to the promoter upon the secret oral condition that the promoter should not use it in any way until four specified persons should each subscribe a like amount. This condition was not fulfilled. The promoter, however, circulated the subscription paper which purported on its face to be a completed contract. Other persons subscribed and paid for stock in reliance on the defendant's subscription and the corporation was organized and contracted large liabilities upon the strength of the subscriptions. It was held that to permit the defendant to relieve himself from liability on the ground of the secret oral condition would be a fraud upon others who had subscribed and upon creditors.

It has also been held, that if a written subscription for stock is delivered to the corporation or its agent, or to a promoter, with the understanding, not expressed in the writing, that it is not to take effect until the performance of a condition or happening of a contingency, the oral condition is void, and the delivery absolute. The court applied the principle governing the delivery of deeds in escrow, that a deed cannot be delivered in escrow to the grantee or obligee or his agent, and that, if it is so delivered, the condition is void, and the delivery absolute and unconditional.⁶⁴ It is believed, however, that these cases should be rested either on estoppel, if no contract was actually completed, or on the invalidity of secret oral provisions for release, assuming the subscription was a binding contract when the paper was delivered to the promoter or the corporation. A subscriber is estopped to set up that his subscription was delivered to the promoter of the corporation subject to an oral condition, where others have subscribed and made payments, and the corporation has been formed, and has expended money and contracted liabilities, all on the faith of the subscriptions, and in ignorance of the oral condition.⁶⁵

⁶⁴ *Wight v. Shelby R. Co.*, 16 B. Mon. (Ky.) 4, 63 Am. Dec. 522; *Minneapolis Threshing Mach. Co. v. Davis*, 40 Minn. 110, 41 N. W. 1026, 3 L. R. A. 796, 12 Am. St. Rep. 701.

⁶⁵ *Minneapolis Threshing Mach. Co. v. Davis*, 40 Minn. 110, 41 N. W. 1026, 3 L. R. A. 796, 12 Am. St. Rep. 701. Compare *Gilman v. Gross*, 97 Wis. 224, 72 N. W. 885, a subscription paper was signed by defendant and left in the hands of the solicitor, not to be binding on defendant unless ten similar subscrip-

tions were obtained. It was held that the subscription was not binding upon either party until delivered to the corporation and accepted by it. The delivery was conditional and there was no evidence to show that creditors had been misled to raise an estoppel.

Tidewater Southern R. Co. v. Merz, 35 Cal. App. 405, 169 Pac. 1054. The entry of a subscription in the stock books of the corporation is not a valid acceptance where the proposition or offer was submit-

§ 40. Subscription of full amount of capital as implied condition.

As a general rule, every person who becomes a subscriber for original stock in a corporation has a right to assume that the full amount of the capital stock fixed by the charter, or by the articles of association or the contract of subscription, will be subscribed in good faith and unconditionally, before he is called upon to pay anything on his subscription; and therefore, in the absence of anything to show a contrary intention on the part of the legislature or the subscribers, every subscription is upon the condition, implied when not expressed, that there shall be no liability thereon until the full capital stock or the required percentage thereof has been in good faith subscribed for.⁶⁶

The general rule that subscriptions are upon the implied condition that the full amount of the capital stock shall be subscribed does not apply where a contrary intention appears from the provisions of the charter, or, from the provisions of the articles of association, or from the action of the stockholders or directors fixing the capital stock, or from the terms of the contracts of subscription.⁶⁷ If it appears therefrom, by express terms or clear implication, that it was intended that the corporation should or

ted to the corporation by the solicitor without the condition endorsed on the duplicate subscription, and where it did not appear that there were other subscribers who could have been defrauded by reliance on the apparent subscription, and no subsequent creditor who could have relied thereon in dealing with the corporation. See *Rehbein v. Rahr*, 109 Wis. 136, 85 N. W. 315. A certificate of incorporation to be delivered to the public by filing with the register of deeds must be given effect according to its terms, although its filing was in contravention of the understanding and directions of some of the signers and it was delivered to take effect only on the signature of another party. This is spoken of as a kind of public estoppel in favor of a public document.

⁶⁶ *Penobscot R. Co. v. Dummer*, 40 Me. 172, 63 Am. Dec. 654; *Salem Mill Dam Corp. v. Ropes*, 6 Pick. (Mass.) 23; *Anderson v. Middle & East Tennessee Cent. R. Co.*, 91

Tenn. 44, 17 S. W. 803; *Curry Hotel Co. v. Mullins*, 93 Mich. 318, 53 N. W. 360; *Bray v. Farwell*, 81 N. Y. 600; *Spellier Elec. Time Co. v. Leedom*, 149 Pa. St. 185, 24 Atl. 197; *Norwich Lock Mfg. Co. v. Hockaday*, 89 Va. 557, 16 S. E. 877; *Denny Hotel Co. of Seattle v. Schram*, 6 Wash. 134, 32 Pac. 1002, 36 Am. St. Rep. 130; *Anvil Min. Co. v. Sherman*, 74 Wis. 226, 42 N. W. 226, 4 L. R. A. 232; *Hughes v. Antietam Mfg. Co. of Washington County*, 34 Md. 316. See note Ann. Cas. 1918 B 1137. "As we said in *Denny Hotel Co. of Seattle v. Schram*, 6 Wash. 134, 32 Pac. 1002, 36 Am. St. Rep. 130, it is an implied part of the contract of subscription that the contract is to be binding and enforceable against the subscriber only after the full capital stock of the corporation has been subscribed."

Flury v. Twin Cities Dairy Co., 136 Wash. 462, 240 Pac. 900.

⁶⁷ *Anderson v. Middle & East Tennessee Cent. R. Co.*, 91 Tenn. 44, 17 S. W. 803.

might engage in business before subscription of the full amount of its capital stock, or make contracts, create debts, or do any other act involving a necessity to call upon stockholders to pay their subscriptions, it cannot be implied that it was intended to make the subscription of the whole amount of the capital stock a condition precedent to liability on subscriptions.⁶⁸

A condition, express or implied, that the full amount of the capital stock, or a certain percentage thereof, shall be subscribed, may be waived like other conditions precedent.⁶⁹ A waiver will generally be implied, for example, if a subscriber takes part in stockholders' meetings, or otherwise acts as a stockholder, before the condition is performed, for a conditional subscription does not make the subscriber a stockholder until performance of the condition.⁷⁰ There is also a waiver of conditions in a subscription where the subscriber acts as a director or officer of the corporation, when his right to do so depends upon his being a stockholder;⁷¹ or where he pays his subscription, or a part thereof, with knowledge of non-performance of conditions precedent.⁷² Acts of a subscriber which would otherwise constitute a waiver of conditions will not have this effect if he does not know at the time that the conditions have not been performed, but supposes that they have.⁷³

⁶⁸ *Arkadelphia Cotton Mills v. Trimble*, 54 Ark. 316, 15 S. W. 776; *Penobscot & K. R. Co. v. Bartlett*, 12 Gray (Mass.) 244, 71 Am. Dec. 753; *Bucksport & B. R. Co. v. Buck*, 65 Me. 536; *Mandel v. Swan Land & Cattle Co.*, 154 Ill. 177, 40 N. E. 462, 27 L. R. A. 313, 45 Am. St. Rep. 124; *Val Verde Hotel Co. v. Hubbell*, 27 N. M. 545, 202 Pac. 982.

⁶⁹ *Anderson v. Middle & East Tennessee Cent. R. Co.*, 91 Tenn. 44, 17 S. W. 803; *Macfarland v. West Side Improvement Ass'n*, 56 Neb. 277, 76 N. W. 584; *Hamilton v. Clarion, M. & P. R. Co.*, 144 Pa. St. 34, 23 Atl. 53, 13 L. R. A. 779; *California Southern Hotel Co. v. Callender*, 94 Cal. 120, 29 Pac. 859, 28 Am. St. Rep. 99.

⁷⁰ *McAllister v. Indianapolis & C. R. Co.*, 15 Ind. 11; *Dayton & C. R. Co. v. Hatch*, 1 Disn. (Ohio) 84, 12 Ohio Dec. 501; *New Hampshire Cent. R. Co. v. Johnson*, 30 N. H. 390, 64 Am. Dec. 300; *Lane v. Brainerd*, 30 Conn. 565; *Enterprise Sheet Metal Works v. Schendel*, 63 Mont. 26, 208 Pac. 933.

⁷¹ *Lane v. Brainerd*, 30 Conn. 565. See note to *Jones v. Dodge*, 97 Ark. 248, 133 S. W. 828, L. R. A. 1915 A 472, 475.

⁷² *In re Cornell's Appeal*, 114 Pa. St. 153, 6 Atl. 258; *Parks v. Evansville, I. & C. Straight Line R. Co.*, 23 Ind. 567; *Union Hotel Co. v. Hersee*, 79 N. Y. 454, 35 Am. Rep. 536. But see *Gettysburg Nat. Bank v. Brown*, 95 Md. 367, 52 Atl. 975, 93 Am. St. Rep. 339, 349, 368.

⁷³ Thus, a stockholder who subscribes on condition that a certain amount of stock shall be taken, and who, without knowledge that the required amount has not been subscribed, waives notice of a stockholders' meeting, and votes by proxy at a special meeting, does not thereby waive performance of the condition. *Portland & F. R. Co. v. Spillman*, 23 Ore. 587, 32 Pac. 688; *Denny Hotel Co. v. Gilmore*, 6 Wash. 152, 32 Pac. 1004.

The same is true of a part payment in ignorance of nonperformance of the condition. *Johnson v. Schar*, 9 S. D. 536, 70 N. W. 838.

III. SUBSCRIPTIONS UPON SPECIAL TERMS.

§ 41. In general.—A subscription upon special terms is an absolute subscription, which makes the subscriber a stockholder, and renders him liable as such, and for the amount of the subscription, as soon as it is accepted, but contains special terms or stipulations. Such a subscription is valid, provided the special terms or stipulations are not such as to constitute a fraud upon the other subscribers or stockholders, or upon the creditors of the corporation.

As was shown in a former section, subscriptions upon special terms—sometimes called subscriptions upon conditions subsequent, and sometimes incorrectly called conditional subscriptions—are very different from subscriptions upon conditions precedent, or conditional subscriptions in the proper sense. A subscription upon condition precedent, or conditional subscription, is a subscription which, while it is a binding contract, does not make the subscriber a stockholder, or render him liable to pay the amount thereof, until the performance or fulfillment of some condition.⁷⁴

A subscription upon special terms, on the other hand, is an absolute and unconditional subscription. It makes the subscriber a stockholder, and renders him absolutely liable to pay the amount thereof according to its terms, from the time it is accepted, but contains special terms limiting the liability of the subscriber, or imposing particular obligations upon the corporation. In the latter case, performance of the stipulations by the corporation is not a condition precedent to liability on the part of the subscriber, but is an independent or collateral agreement, for a breach of which the corporation will be liable in damages.⁷⁵ A threatened violation of such a contract may sometimes be enjoined. Thus, an absolute and unconditional subscription to stock in a railroad company may stipulate, not as a condition precedent, but as a special term or collateral contract, that the company shall construct its road along a certain route, or that it shall establish a depot at a certain point. Performance of the stipulation is not necessary to render the subscriber liable on his subscription, and entitle the corporation to make and collect calls. Nor is it a condition precedent to

⁷⁴ Ante, § 37.

⁷⁵ *McMillan v. Maysville & L. R. Co.*, 15 B. Mon. (Ky.) 218, 61 Am. Dec. 181; *Paducah & M. R. Co. v. Parks*, 86 Tenn. 554, 8 S. W. 842;

Morrow v. Nashville Iron & Steel Co., 87 Tenn. 262, 10 S. W. 495, 3 L. R. A. 37, 10 Am. St. Rep. 658; *Red Wing Hotel Co. v. Friedrich*, 26 Minn. 112, 1 N. W. 827.

the subscriber's becoming a stockholder. It is an absolute subscription for these purposes. Failure of a corporation to perform the stipulation merely gives the subscriber a right of action against it.⁷⁶ If the special term, however, or undertaking on the part of the corporation, forms substantially the whole consideration for the subscription, a breach thereof by the corporation before the subscription is paid will discharge the subscriber, except as against creditors, on the ground that there is a failure of consideration.⁷⁷

A corporation has no authority to accept subscriptions upon special terms, where the terms are such as to constitute a fraud upon the other subscribers, or upon persons who may become creditors of the corporation in reliance upon a *bona fide* and regular subscription of the authorized capital stock. In such a case, however, the subscription is not void. The fraudulent and unauthorized stipulations are void, and the subscriber is liable on his subscription as if no such stipulations had been inserted.⁷⁸ It has been held, therefore, in many cases, that any secret agreement between a subscriber for stock in a corporation and the corporation or its agent or promoters, by which he is allowed to subscribe upon different terms than other subscribers, since it is a fraud upon the latter is void; and any secret agreement by which he is to be released in whole or in part from liability on his subscription, since it is a fraud both upon the other subscribers and upon persons who afterwards become creditors of the corporation, is void, and the subscription may be enforced by the corporation, or for the benefit of creditors, as if no such agreement had been made.⁷⁹

⁷⁶ Paducah & M. R. Co. v. Parks, 86 Tenn. 554, 18 S. W. 842; Henderson & N. R. Co. v. Leavell, 16 B. Mon. (Ky.) 358; Bobzin v. Gould Balance Valve Co., 140 Iowa 744, 118 N. W. 40.

⁷⁷ Independent Harvester Co. v. Anderson, 45 S. D. 60, 186 N. W. 112; Lauer v. Raymond, 190 N. Y. App. Div. 319, 180 N. Y. Supp. 31; Frankfort & S. Turnpike Co. v. Churchill, 6 T. B. Mon. (Ky.) 427, 17 Am. Dec. 159. See also, Caley v. Philadelphia & Chester County R. Co., 80 Pa. St. 363; Seymour v. Detroit Copper & Brass Rolling Mills, 56 Mich. 117, 22 N. W. 317, 23 N. W. 186; Auburn Bolt & Nut Works v. Shultz, 143 Pa. St. 256, 22 Atl. 904.

⁷⁸ Schulte v. Boulevard Gardens Land Co., 164 Cal. 464, 129 Pac.

582, 44 L. R. A. (N. S.) 156, Ann. Cas. 1914 B 1093; Sarbach v. Kansas Fiscal Agency Co., 86 Kan. 734, 122 Pac. 113, Ann. Cas. 1913 C 415; Upton v. Tribilcock, 91 U. S. 45, 23 L. Ed. 203; New Albany & Salem R. Co. v. Fields, 10 Ind. 187; Piscataqua Ferry Co. v. Jones, 39 N. H. 491; Miller v. Hanover Junction & S. R. Co., 87 Pa. St. 95, 30 Am. Rep. 349; Downie v. White, 12 Wis. 176, 78 Am. Dec. 731.

⁷⁹ Burke v. Smith, 16 Wall. (U. S.) 390, 21 L. Ed. 361; Upton v. Tribilcock, 91 U. S. 45, 23 L. Ed. 203; Melvin v. Lamar Ins. Co., 80 Ill. 446, 22 Am. Rep. 199; Union Mut. Life Ins. Co. v. Frear Stone Mfg. Co., 97 Ill. 537, 37 Am. Rep. 129; White Mountains R. Co. v. Eastman, 34 N. H. 124; Piscataqua Ferry Co. v. Jones, 39 N. H. 491;

A corporation may, on the sale of its stock, give the subscriber or purchaser the option to rescind or resell the stock to the corporation.⁸⁰ But the mere oral promise of the agent that the company will repurchase the stock if the subscriber desires to sell cannot vary or add to the terms of the written contract.⁸¹

In *Gasser v. Great Northern Ins. Co.*,⁸² the plaintiff in Duluth subscribed for two hundred shares of stock in the defendant company and received receipt providing that in the event of the failure of the corporation to move its general offices, the transaction should be null and void and the money refunded. This was held a sale of the stock with an option to return it upon failure of the condition. A subscriber's remedy on such a failure is to return the stock and demand a return of his money. Under the law in some states, however, a corporation may not on the issue of its stock give the right of rescission or resale.

Of course, stipulations in a subscription, as a stipulation that the whole or a part of it need not be paid, or will be returned, cannot constitute a fraud upon the other stockholders if they consent. Such a stipulation, therefore, is valid as between the subscriber and the corporation, in the absence of charter or statutory restrictions, if all the stockholders know of it, and expressly or impliedly consent.⁸³ Nor does such an agreement constitute a fraud upon existing creditors of the corporation, where there is no withdrawal of assets, or upon persons who subsequently become creditors with notice, and they cannot complain.⁸⁴ It is void,

Wetherbee v. Baker, 35 N. J. Eq. 501; *Marshall Foundry Co. v. Kilian*, 99 N. C. 501, 6 S. E. 680, 6 Am. St. Rep. 539; *Wilson v. Hundley*, 96 Va. 96, 30 S. E. 492, 70 Am. St. Rep. 837; *Quartz Glass & Mfg. Co. v. Joyce*, 27 Cal. App. 523, 150 Pac. 648; *Reiff v. Nebraska-California Colony Co.*, 277 Fed. 417.

⁸⁰ *Schulte v. Boulevard Gardens Land Co.*, 164 Cal. 464, 468, 129 Pac. 582, 44 L. R. A. (N. S.) 156, Ann. Cas. 1914 B 1013; *Wolf v. Excelsior Automatic Scale & Supply Co.*, 270 Pa. 547, 113 Atl. 569.

⁸¹ *Schuster v. North American Hotel Co.*, 106 Neb. 672, 184 N. W. 136, 186 N. W. 87. See *California Credit & Collection Corp. v. Brandlin*, — Cal. App. —, 243 Pac. 41, 43, oral promise of agent to repurchase, unless made fraudulently and with

no intention to perform, no defense to written contract.

⁸² 145 Minn. 205, 176 N. W. 484, 179 N. W. 727. In *Independent Harvester Co. v. Malzohn*, 147 Minn. 145, 179 N. W. 727, it is held that where a corporation refuses to perform the oral contract of its agent in selling stock to employ the defendant as local agent, it cannot collect a note for the stock where he offers to return the certificate of stock. Where an agent makes an unauthorized contract, the principal must accept or reject it as a whole.

⁸³ *Seovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *Winston v. Dorsett Pipe & Paving Co.*, 129 Ill. 64, 21 N. E. 514, 4 L. R. A. 507. And see ante, § 209.

⁸⁴ *Johns v. Clothier*, 78 Wash. 602, 139 Pac. 755.

however, notwithstanding the consent of all the stockholders, as against persons who subsequently become creditors of the corporation without notice, and in reliance, which will be presumed in the absence of evidence to the contrary, upon the full amount of the capital stock being paid or secured.⁸⁵

The doctrine invalidating secret agreements between the officers of a corporation and a subscriber, by which the latter is to be released in whole or in part from liability on his subscription, does not apply to agreements between the promoters or particular stockholders of a corporation and a subscriber, by which the former are to buy back his stock so as to let him out, for such an agreement as this is between the parties only, and does not affect the subscriber's liability on his subscription. Such an agreement is not a fraud upon other subscribers.⁸⁶

IV. WITHDRAWAL, RELEASE, AND DISCHARGE OF SUBSCRIBERS.

§ 42. In general.—After a subscription has become a binding contract, the subscriber cannot surrender his shares and withdraw, so as to avoid liability on his subscription, without the consent of the corporation, unless he has the right to do so under valid special terms of his contract. But he may be released by the corporation, or discharged from liability, as follows:

He cannot be released by the corporation from liability on his subscription, otherwise than by a bona fide compromise, without the consent of all the other stockholders. Nor can he be released with the consent of all the other stockholders to the prejudice of creditors of the corporation. He may be released, however, with the consent of all the stockholders, if there is no fraud upon creditors. And he may be released by virtue of a bona fide compromise without the consent of other stockholders, and as against creditors.

Withdrawal and release of subscribers.—A subscriber for stock in a corporation may revoke his offer and withdraw at any time before the subscription has been accepted by the corporation, unless the subscription is binding, prior to its acceptance, on some

⁸⁵ Seovill v. Thayer, 105 U. S. 143, 26 L. Ed. 968. And see ante, § 210.

⁸⁶ Morgan v. Struthers, 131 U. S. 246, 33 L. Ed. 132, 9 Sup. Ct. 726; Meyer v. Blair, 109 N. Y. 600, 17 N. E. 228, 4 Am. St. Rep. 500;

Traphagen v. Sagar, 63 Minn. 317, 65 N. W. 633; Rogers v. Burr, 105 Ga. 432, 31 S. E. 438, 70 Am. St. Rep. 50. See Hulen v. Stuart, 191 Cal. 562, 217 Pac. 750.

such theory as that there is a contract between the subscribers.⁸⁷ It is otherwise, however, after a subscription has been accepted by the corporation, and become a binding contract. In such a case, the subscriber cannot withdraw or surrender his shares, and thereby avoid liability on his subscription as made, without the consent of the corporation,⁸⁸ unless he is given the right to withdraw by valid special terms of his contract.⁸⁹ Nor can he do so, as a general rule, even when the corporation consents, if any of the other stockholders object, or if there is any prejudice to creditors.⁹⁰

There can be no doubt that a corporation may effectually release a subscriber from liability on his subscription, in whole or in part, or allow him to modify his contract, if all the stockholders expressly or impliedly consent, and if there is no fraud upon existing or subsequent creditors,⁹¹ provided there is a consideration for the release.⁹² It is thoroughly well settled, however, that a corporation cannot, except in pursuance of a *bona fide* compromise, release a stockholder from liability on his subscription, by accepting a surrender of his shares, or purchasing the same, or otherwise, as against dissenting stockholders, or as against creditors of the corporation. As against them, a release, except as stated above, is void.⁹³

⁸⁷ *Hudson Real Estate Co. v. Tower*, 156 Mass. 82, 30 N. E. 465, 32 Am. St. Rep. 434; s. c., 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379; *Bryant's Pond Steam Mill Co. v. Felt*, 87 Me. 234, 32 Atl. 888, 33 L. R. A. 593, 47 Am. St. Rep. 323. And see ante, § 33.

⁸⁸ *Selma & T. R. Co. v. Tipton*, 5 Ala. 787, 39 Am. Dec. 344; *Hutchins v. Smith*, 46 Barb. (N. Y.) 235; *Armstrong v. Karshner*, 47 Ohio St. 276, 24 N. E. 897.

⁸⁹ A subscriber may be given the right to return his stock and withdraw by the special terms of his contract, provided the agreement does not operate as a fraud upon other subscribers, or upon creditors of the corporation, but not otherwise. *Jones v. Johnson*, 86 Ky. 530, 6 S. W. 582; *Winston v. Dorsett Pipe & Paving Co.*, 129 Ill. 64, 21 N. E. 514, 4 L. R. A. 507. See ante, § 41.

⁹⁰ See *infra*, this section; *Lebens v. Nelson*, 148 Minn. 240, 181 N. W. 350.

⁹¹ *Cooper v. Frederick*, 9 Ala. 738; *Glenn v. Hatchett*, 91 Ala. 316, 8

So. 656; *Winston v. Dorsett Pipe & Paving Co.*, 129 Ill. 64, 21 N. E. 514, 4 L. R. A. 507; *Non-Electric Fibre Mfg. Co. v. Peabody*, 21 N. Y. App. Div. 247, 47 N. Y. Supp. 677; *Shoemaker v. Washburn Lumber Co.*, 97 Wis. 585, 73 N. W. 333; *Jones v. Johnson*, 86 Ky. 530, 6 S. W. 582; *Morgan v. Lewis*, 46 Ohio St. 1, 17 N. E. 558. See *Murphy v. Pantan*, 96 Wash. 637, 165 Pac. 1074; *Pasadena Rapid Transit Co. v. Munson*, 37 Cal. App. 352, 74 Pac. 109.

⁹² *Northrop v. Bushnell*, 38 Conn. 498; *Murphy v. Pantan*, 96 Wash. 637, 165 Pac. 1074.

⁹³ *Sawyer v. Hoag*, 17 Wall. (U. S.) 620, 21 L. Ed. 731; *Cartwright v. Dickinson*, 88 Tenn. 476, 12 S. W. 1030, 7 L. R. A. 706, 17 Am. St. Rep. 910; *Currier v. Lebanon Slate Co.*, 56 N. H. 262; *White Mountains R. R. v. Eastman*, 34 N. H. 124; *Marshall Foundry Co. v. Killian*, 99 N. C. 501, 6 S. E. 680, 6 Am. St. Rep. 539; *Melvin v. Lamar Ins. Co.*, 80 Ill. 446, 22 Am. Rep. 199; *Carter v. Union Printing Co.*, 54 Ark. 576, 16 S. W. 579; *Hughes v. Antietam Mfg.*

The doctrine invalidating the release of a subscriber by the corporation as against dissenting stockholders and creditors does not prevent a *bona fide* compromise between a corporation and a subscriber. If a stockholder is unable to pay for his shares, and the transaction is in good faith, the corporation may accept a surrender of his shares and release him from any further liability.⁹⁴ Nor does the general rule apply when there is a *bona fide* dispute as to liability on a subscription. In such a case, the corporation, if the transaction is in good faith, may compromise the dispute, accepting a surrender of his shares from the subscriber, and releasing him from further liability.⁹⁵

§ 43. A subscriber is discharged from liability:

- (1) By a material or fundamental alteration or amendment of the charter of the corporation, without his consent.
- (2) By a consolidation of the corporation with another, without his consent, where the consolidated corporation is of a different character, or has materially different powers.

A subscriber is not discharged from liability by mismanagement or abandonment of the business.

Discharge by alteration or amendment of charter, and by consolidation.—If a corporation, after subscriptions to its capital stock, procures or accepts an alteration or amendment of its charter, whereby its charter, object, or powers are materially or fundamentally changed, there is a material alteration of the contracts of the subscribers, and it follows that those who do not assent to

Co., 34 Md. 316; *Lebens v. Nelson*, 148 Minn. 240, 181 N. W. 350; *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286; *Lake Ontario, A. & N. Y. R. Co. v. Mason*, 16 N. Y. 451; *Mann v. Pentz*, 2 Sandf. Ch. (N. Y.) 257; *Boney v. Williams*, 55 N. J. Eq. 691; *Bedford R. Co. v. Bowser*, 48 Pa. St. 29; *Nichols v. Stevens*, 123 Mo. 96, 25 S. W. 578, 27 S. W. 613, 45 Am. St. Rep. 514; *Gogebie Investment Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. 726, 23 Am. St. Rep. 417; *Hall v. Henderson*, 126 Ala. 449, 28 So. 531, 61 L. R. A. 621, 85 Am. St. Rep. 53.

That subsequent creditors cannot complain, see *Shoemaker v. Washburn Lumber Co.*, 97 Wis. 585, 73 N. W. 333. But see *Mackall v. Po-*

cock, 136 Minn. 8, 161 N. W. 228, L. R. A. 1917 C 390; *Chrisman-Sawyer Banking Co. v. Independence Wool Mfg. Co.*, 168 Mo. 634, 68 S. W. 1026.

⁹⁴ *Thomas v. Wentworth Hotel Co.*, 16 Cal. App. 403, 17 Pac. 1041; *Trevor v. Whitworth*, 12 App. Cas. 409; *New Haven Trust Co. v. Gaffney*, 73 Conn. 480, 47 Atl. 760.

⁹⁵ *Thomas v. Wentworth Hotel Co.*, 16 Cal. App. 403, 117 Pac. 1041; *New Albany v. Burke*, 11 Wall. (U. S.) 96, 20 L. Ed. 155; *Whitaker v. Grummond*, 68 Mich. 249, 36 N. W. 62; *State v. Oberlin Building & Loan Ass'n*, 35 Ohio St. 258; *Morgan v. Lewis*, 46 Ohio St. 1, 17 N. E. 558; *New Haven Trust Co. v. Gaffney*, 73 Conn. 480, 47 Atl. 760

the change are discharged from liability on their subscriptions. And they may set up the alteration or amendment as a defense in an action to enforce their subscriptions, whether the action is brought by the corporation itself, or by creditors, or by a receiver or assignee in bankruptcy.⁹⁶ According to the better opinion, a subscriber is discharged by a material and fundamental alteration or amendment of the charter of the corporation, even when the legislature has the reserved power to alter, amend, or repeal the charter, for such a reservation of power is intended for the benefit and protection of the public, and is not to be construed as authorizing the legislature or a majority of the stockholders to bind a dissenting stockholder by an amendment which is not made for the protection of the public, and which is radical or fundamental, so as to make the corporation or the undertaking something essentially different from what was intended by the subscribers at the time of their subscriptions.⁹⁷ There is no discharge of dissenting subscribers, however, by an alteration or amendment of the charter of the corporation, under the reserved power to alter, amend, or repeal, or even where there is no such reserved power, where it does not fundamentally change the character, objects, or powers of the corporation, but is merely in furtherance of the original purpose.⁹⁸ Nor is there any discharge of a subscriber by reason of an alteration or amendment which is authorized by the charter of the corporation or by a general law in force at the time of his subscription, for in such a case the right of a majority to bind him

⁹⁶ *Nugent v. Board Sup'rs Putnam Co.*, 19 Wall. (U. S.) 241, 22 L. Ed. 83; *Clearwater v. Meredith*, 1 Wall. (U. S.) 25, 17 L. Ed. 604; *Proprietors of Union Locks & Canals v. Towne*, 1 N. H. 44, 8 Am. Dec. 32; *Kenosha, R. & R. I. R. Co. v. Marsh*, 17 Wis. 13; *Norwich Lock Mfg. Co. v. Hockaday*, 89 Va. 557, 16 S. E. 877; *Hartford & N. H. R. Co. v. Crosswell*, 5 Hill (N. Y.) 383, 40 Am. Dec. 354; *Dorris v. Sweeney*, 60 N. Y. 463; *Woods Motor Vehicle Co. v. Brady*, 181 N. Y. 145, 73 N. E. 674; *Campbell v. Coin Mach. Mfg. Co.*, 96 Ore. 119, 188 Pac. 197; *New Nueces Hotel Co. v. Weil Bros.* (Tex. Civ. App.), 243 S. W. 731.

⁹⁷ *American Trading & Importing Co. v. Miron & Lifson*, 98 N. J. Law 737, 121 Atl. 744. Provision in articles of incorporation for redemption of stock held a material depar-

ture from contract of subscription, disentitling corporation to recover balance due and entitling subscriber to recover partial payment. *Kenosha, R. & R. I. R. Co. v. Marsh*, 17 Wis. 13. And see post, §§ 272, 281. See also, *Mayfield v. Alton Railway, Gas & Electric Co.*, 198 Ill. 528, 65 N. E. 100; *Avondale Land Co. v. Shook*, 170 Ala. 379, 54 So. 268. Contra: *Schenectady & Saratoga Plank Co. v. Thatcher*, 11 N. Y. 102; *Troy & R. R. Co. v. Kerr*, 17 Barb. (N. Y.) 581; *Durfee v. Old Colony & F. R. R. Co.*, 5 Allen (Mass.) 230 (semble).

⁹⁸ *Clearwater v. Meredith*, 1 Wall. (U. S.) 25, 17 L. Ed. 604; *Buffalo & N. Y. City R. Co. v. Dudley*, 14 N. Y. 336; *Taggare v. Western Maryland R. Co.*, 24 Md. 563, 89 Am. Dec. 760.

by the amendment is a term of his contract.⁹⁹ Nor are subscribers discharged where they consent to the alteration or amendment at the time it is made, or afterwards. And if a subscriber with knowledge fails to give notice of his dissent within a reasonable time, it is equivalent to consent.¹⁰⁰

What has just been said applies where consolidation is relied upon as a discharge. A subscriber for stock in a corporation is discharged from any liability on his subscription if the corporation is consolidated with another under a statute passed after the subscription, where the state has not reserved the power to alter, amend, or repeal the charter, if he does not consent to the consolidation.¹⁰¹

Mismanagement or cessation of business.—If the affairs of a corporation are mismanaged by the directors or other officers, or by the majority of the stockholders, stockholders not participating in the fraudulent or wrongful acts or neglect have a remedy in equity by suit for an injunction, or to hold the guilty officers or stockholders liable to the corporation for any damages sustained by the corporation; but mismanagement of a corporation does not discharge a stockholder from liability on his subscription, and is no defense in an action thereon.¹⁰² Nor is a subscriber discharged by delay on the part of the corporation in constructing its works or otherwise carrying out its objects, where there has been no abandonment of the enterprise, or by the fact that the corporation has temporarily abandoned the enterprise, or permanently abandoned a part of it.¹⁰³ Even a permanent abandonment or failure of the

⁹⁹ *Nugent v. Board Sup'rs Putnam Co.*, 19 Wall. (U. S.) 241, 22 L. Ed. 83; *Edwards v. People*, 88 Ill. 340; *Bish v. Johnson*, 21 Ind. 299; *Witter v. Mississippi, O. & R. R. Co.*, 20 Ark. 463. See post, §§ 282, 283.

¹⁰⁰ *Martin v. Pensacola & G. R. Co.*, 8 Fla. 370, 73 Am. Dec. 713; *Marietta & C. R. Co. v. Elliott*, 10 Ohio St. 57; *Bedford R. Co. v. Bowser*, 48 Pa. St. 29.

¹⁰¹ *Tuttle v. Michigan Air Line R. Co.*, 35 Mich. 247; *Board Sup'rs Fulton Co. v. Mississippi & W. R. Co.*, 21 Ill. 338; *Sparrow v. Evansville & C. R. Co.*, 7 Ind. 369; *State v. Bailey*, 16 Ind. 46, 79 Am. Dec. 405.

¹⁰² *Preston v. Jeffers*, 179 Ky. 384, 200 S. W. 654; *Hards v. Platte Val-*

ley Improvement Co., 46 Neb. 709, 65 N. W. 781; *Merrill v. Reaver*, 50 Iowa 404; *Smith v. Tallassee Branch of Central Plank-Road Co.*, 30 Ala. 650; *Glenn v. Rosborough*, 48 S. C. 272, 26 S. E. 611; *Cravens v. Eagle Cotton Mills Co.*, 120 Ind. 6, 21 N. E. 981, 16 Am. St. Rep. 298; *Uerner v. Sollenberger*, 89 Md. 316, 43 Atl. 810; *Badger Dairy Co. v. Hansen*, 189 Wis. 547, 208 N. W. 477. Attempt of directors to do *ultra vires* acts, no defense. See *Cook, Corporations* (8th Ed.) p. 595, par. 187.

¹⁰³ *McMillan v. Maysville & L. R. Co.*, 15 B. Mon. (Ky.) 218, 61 Am. Dec. 181; *Gibson v. Columbia & N. R. Turnpike & Bridge Co.*, 18 Ohio St. 396; *Buffalo & J. R. Co. v. Gifford*, 87 N. Y. 294; *Raleigh Imp. Co. v. Andrews*, 176 N. C. 280, 96 S. E.

enterprise will not discharge a subscriber where payment of his subscription is necessary for the satisfaction of debts of the corporation, or for adjustment as between the stockholders.¹⁰⁴ But a permanent abandonment or total failure will operate as a discharge as between the subscriber and the corporation, where there are no debts, nor any question as to the rights of the different stockholders.¹⁰⁵

§ 44. Subscriptions voidable for fraud.—A subscription induced by fraudulent representations of directors, agents or promoters of a corporation is voidable at the election of the subscriber, and he may recover what he has paid within a reasonable time, provided rights of creditors have not intervened. If the corporation becomes insolvent after the subscription, rescission may still be granted if the subscriber acts with great promptitude. The claims of subsequent creditors are paramount to those of defrauded stockholders.

Effect of fraud.—As a general rule, if a person is induced to subscribe for or purchase stock by false and fraudulent representations on the part of the managing officers of the corporation, or of any other agent for whose fraud the corporation is responsible, or even of promoters before the organization of the corporation, the subscription is voidable at his option, on discovery of the fraud, or within a reasonable time afterwards, provided superior rights of creditors have not arisen. The defrauded subscriber will be entitled to rescind his contract, and maintain an action to recover what he has paid, or sue in equity to cancel the contract and be relieved from any further liability as a stockholder, and for recovery of what he has paid.¹⁰⁶ Or he may set up the fraud as a defense in an action by the corporation, or, subject to limitations,

1032. See *Huster v. Newkirk Creamery & Ice Co.*, 42 Okla. 790, 141 Pac. 790, L. R. A. 1915 A 390 note, on effect upon a stock subscription contract of the voluntary cessation or abandonment of business by the corporation. But see *Wicks Stone Co. v. Dickason*, 276 Ill. 590, 115 N. E. 76.

¹⁰⁴ *Hardy v. Merriweather*, 14 Ind. 203; *Bish v. Bradford*, 17 Ind. 490; *McMillan v. Maysville & L. R. Co.*, 15 B. Mon. (Ky.) 218, 61 Am. Dec. 181; *Four Mile Valley R. Co. v. Bailey*, 18 Ohio St. 208.

¹⁰⁵ *McMillan v. Maysville & L. R. Co.*, 15 B. Mon. (Ky.) 218, 61 Am. Dec. 181; *Pittsburgh & C. R. Co. v. Byers*, 32 Pa. St. 22, 72 Am. Dec. 770; *Blake v. Brown*, 80 Iowa 277, 45 N. W. 751; *Wicks Stone Co. v. Dickason*, 276 Ill. 590, 115 N. E. 176. See note, power of receiver to collect unpaid subscriptions to equalize losses, 38 Harv. Law Rev. 112.

¹⁰⁶ *Stone v. Walker*, 201 Ala. 130, 77 So. 554, L. R. A. 1918 C 839 (fraud of promoter); s. c., 205 Ala. 381, 87 So. 862; *Vreeland v. New*

by a receiver or assignee, to recover the amount of the subscription, or of an assessment thereon, or the price in case of a sale, or in an action on a note given by him in payment.¹⁰⁷

This doctrine has repeatedly been applied in the case of false representations contained in the prospectus of a corporation, issued by it or its officers for the purpose of setting forth facts which will induce persons to subscribe for its stock.¹⁰⁸ But they apply equally to oral representations made by the agents of the corporation in soliciting subscriptions, for the rule excluding evidence of prior or contemporaneous oral stipulations or agreements to add to or vary a written contract of subscription does not apply to the proof of false and fraudulent representations by which the subscriber was induced to enter into the contract.¹⁰⁹ Even a provision in the sub-

Jersey Stone Co., 29 N. J. Eq. 188; Tyler v. Savage, 143 U. S. 79, 36 L. Ed. 82, 12 Sup. Ct. 340; Sherman v. American Stove Co., 85 Mich. 169, 48 N. W. 537; Bosley v. National Machine Co., 123 N. Y. 550, 25 N. E. 990; Boshier v. Richmond & H. Land Co., 89 Va. 455, 16 S. E. 360, 37 Am. St. Rep. 879; Coles v. Kennedy, 81 Iowa 360, 46 N. W. 1088, 25 Am. St. Rep. 503. See 22 Columbia Law Rev. 477.

A few courts hold that a subscriber cannot defeat an action by the corporation by showing fraudulent representations of the promoters who were not agents of the corporation. St. Johns Mfg. Co. v. Munger, 106 Mich. 90, 64 N. W. 3, 29 L. R. A. 63, 58 Am. St. Rep. 468; Oldham v. Mt. Sterling Improvement Co., 103 Ky. 529, 45 S. W. 799. Contra, Anderson v. Scott, 70 N. H. 350, 47 Atl. 607; Stone v. Walker, 201 Ala. 130, 77 So. 554, L. R. A. 1918 C 839. See 24 Harvard Law Review 147; 16 *ibid.* 380, 85 Am. St. Rep. 385 note.

¹⁰⁷ Central Ry. Co. of Venezuela v. Kisch, L. R. 2 H. L. 99; Crossman v. Penrose Ferry Bridge Co., 26 Pa. St. 69; Spellier Electric Time Co. v. Leedom, 149 Pa. St. 185, 24 Atl. 197; Virginia Land Co. v. Haupt, 90 Va. 533, 19 S. E. 168, 44 Am. St. Rep. 939; Zang v. Adams, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249; Savage v. Bartlett, 78 Md. 561, 28 Atl. 414; Fear v. Bartlett, 81 Md. 435, 32 Atl. 322, 33 L. R. A. 721.

In Field v. Austin, 131 Cal. 379,

382, 63 Pac. 692, 693, it is said, quoting from Toby v. Oregon Pac. R. Co., 98 Cal. 498, 33 Pac. 550: "There are three methods by which, in cases like the present, a party defrauded may obtain relief: (1) Cancellation or rescission, etc.; . . . (2) affirmative relief by an action to recover compensation for the injury sustained by the fraud of the defendant; . . . (3) defensive relief, whereby the fraud is set up by way of defense to defeat an action brought to enforce an apparent obligation or liability."

¹⁰⁸ Oakes v. Turquand, L. R. 2 H. L. 325; Reese River Silver Min. Co. v. Smith, L. R. 4 H. L. 64; Savage v. Bartlett, 78 Md. 561, 28 Atl. 414; Fear v. Bartlett, 81 Md. 435, 32 Atl. 322, 33 Atl. 721; Johnson v. Nebraska Bldg. & Inv. Co., 109 Neb. 235, 190 N. W. 590; Crump v. United States Min. Co., 7 Grat. (Va.) 352, 56 Am. Dec. 116; Boshier v. Richmond & H. Land Co., 89 Va. 455, 16 S. E. 360, 37 Am. St. Rep. 879; Aaron Reefs, Ltd. v. Twiss, [1896] App. Cas. 273, 285.

¹⁰⁹ New York Exch. Co. v. De Wolf, 31 N. Y. 273; Hineley v. Sac Oil & Pipe Line Co., 132 Iowa 396, 107 N. W. 629, 119 Am. St. Rep. 564; Schuster v. North American Hotel Co., 106 Neb. 672, 679, 186 N. W. 87, 184 N. W. 136. Provision in subscription contract held not to relieve company of responsibility for agent's fraudulent representations. Johnson v. Nebraska Bldg. & Inv. Co., 109 Neb. 235, 190 N. W. 590.

scription contract that no representations, statements or agreements made by the agent shall be binding on the corporation will not relieve the principal from responsibility for fraudulent representations made by its agents as distinguished from promises.^{109a}

What amounts to fraud in procuring subscriptions.—In determining whether a fraud has been committed in procuring a subscription to stock, the same principles are to be applied as in the case of any other contract.¹¹⁰ Among the representations which have been held to be material, false representations of fact constituting fraud are representations that the corporation has purchased or owns certain property or rights,¹¹¹ that its property cost a certain sum,¹¹² that it is free from incumbrance,¹¹³ that land owned by it contains valuable mines in profitable operation.¹¹⁴

False and fraudulent representations as to the financial condition of a corporation, contained in reports issued by it to its stockholders, will constitute fraud if either they or others rely thereon in afterwards subscribing for stock,¹¹⁵ as that the corporation is in a solvent and prosperous condition, the representation being

^{109a} In a California case, the agreement contained the following provisions: "The subscription contract . . . contains the entire contract between the subscriber and the company and no agent or representative of the company, or any other person, has any power to change or alter the terms of this subscription. . . . Verbal or other agreements between agents and applicants contrary to the terms of this contract are not authorized and will not be recognized by the company." It was held that: "The statement in the subscription agreement that 'verbal or other agreements between agents and applicants contrary to the terms of this contract are not authorized and will not be recognized by the company' does not preclude proof of fraudulent representations by which the defendant was induced to execute the agreement and the promissory note. *Mooney v. Cyriacks*, 185 Cal. 70, 82, 195 Pac. 922; *Whiting v. Squeglia*, 70 Cal. App. 108, 232 Pac. 986, 988." *California Credit & Collection Corp. v. Randall*, — Cal. App. —, 244 Pac. 958; *Schuster v. North American Hotel Co.*, *supra*,

¹⁰⁹ⁿ Compare *Jones v. Bankers' Trust Co.*, 235 Fed. 649.

¹¹⁰ *Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99, 125; *Burns v. Bauer*, 37 Cal. App. 251, 174 Pac. 346; *Steele v. Kirven*, 120 S. C. 88, 110 S. E. 836.

¹¹¹ *Ross v. Estates Inv. Co.*, 3 Ch. App. 682; *Ramsey v. Thompson Mfg. Co.*, 116 Mo. 318, 22 S. W. 719; *Savage v. Bartlett*, 78 Md. 561, 28 Atl. 414; *Britton Milling Co. v. Williams*, 44 S. D. 464, 184 N. W. 265, 21 A. L. R. 1352; *Cumberland Co-Op. Bakeries v. Lawson*, 91 W. Va. 245, 112 S. E. 568.

¹¹² *Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249.

¹¹³ *Water Valley Mfg. Co. v. Seaman*, 53 Miss. 655; *McClellan v. Scott*, 24 Wis. 81.

¹¹⁴ *Reese River Silver Min. Co. v. Smith*, L. R. 4 H. L. 64.

¹¹⁵ *New Brunswick & C. Railway & Land Co. v. Conybeare*, 9 H. L. Cas. 711; *Western Bank of Scotland v. Addie*, L. R. 1 H. L. Sc. 145. See *Davis v. Louisville Trust Co.*, 181 Fed. 10, 30 L. R. A. (N. S.) 1011 (false reports to commercial agency); *Rumery v. Standard Seed Tester Co.*, 194 Iowa 325, 189 N. W. 667.

known to be false.¹¹⁶ Misrepresentations as to capital stock may be such fraud as to warrant rescission as that all or a certain amount of the capital stock has been subscribed for, or that it has been subscribed for by particular persons,^{116a} that a certain amount has been actually paid in,¹¹⁷ and is to be paid for at par in cash or property at actual value,¹¹⁸ that not more than a certain amount of stock and bonds will be issued, where a greater amount has already been issued.¹¹⁹

Some cases have held that a subscriber, when sued upon his subscription, cannot set up as a defense that the corporation has made special agreements with other stockholders, or has released other stockholders, unless his subscription is voidable for fraud in its procurement, for if the special agreement or release is in fraud of his rights, it is void as against him, and if it is valid he has no ground for complaint.¹²⁰ This view seems unsound. Where a subscriber is induced to make his subscription relying upon the apparent genuineness of prior fictitious subscriptions, the prevailing

¹¹⁶ Bell's Case, 22 Beav. 35; Tyler v. Savage, 143 U. S. 79, 36 L. Ed. 82, 12 Sup. Ct. 340; Dorsey Mach. Co. v. McCaffrey, 139 Ind. 545, 38 N. E. 208, 47 Am. St. Rep. 290; Sherman v. American Stove Co., 85 Mich. 169, 48 N. W. 537; Vest v. Farmers' Co-Op. Elevator Co., 108 Neb. 407, 187 N. W. 892, 894. Cumberland Co-Op. Bakeries v. Lawson, 91 W. Va. 245, 112 S. E. 568.

California Credit & Collection Corp. v. Randall, — Cal. App. —, 244 Pac. 958: "It appears without conflict that the defendant was induced to execute the agreement and the note by the false representation that the packing company had paid, and was paying, dividends of 12 per cent. Such fraudulent representation is a sufficient defense. Dox v. R. E. Lomax Co., 29 Cal. App. 718, 156 Pac. 874; 6 Cal. Jur. 770."

^{116a} Ross v. Estates Inv. Co., 3 Ch. App. 682; Spellier Electric Time Co. v. Leedom, 149 Pa. St. 185, 24 Atl. 197; Coles v. Kennedy, 81 Iowa 360, 46 N. W. 1088, 25 Am. St. Rep. 503.

¹¹⁷ Ramsey v. Thompson Mfg. Co., 116 Mo. 313, 22 S. W. 719; State v. Jefferson Turnpike Co., 3 Humph. (Tenn.) 805.

¹¹⁸ Ritzwoller v. Lurie, 225 N. Y.

464, 122 N. E. 634; Steele v. Coleman, 120 S. C. 158, 110 S. E. 836.

Metcalfe v. Mental Science Industrial Ass'n, 127 Wash. 50, 220 Pac. 1. It is not regarded as a fraud upon persons subsequently acquiring stock in a corporation to transfer 250,000 shares to a person K for an inadequate consideration, and subsequent stockholders cannot have such stock canceled in an action on behalf of the corporation, where all the then existing trustees and stockholders knew and approved of the issue as compensation for promotion services and property. But compare Mason v. Carrothers, 105 Me. 392, 74 Atl. 1030; noted 23 Harvard Law Rev. 566.

¹¹⁹ Weems v. Georgia Midland & G. R. Co., 84 Ga. 356, 11 S. E. 501; s. c., 88 Ga. 303, 14 S. E. 583.

¹²⁰ Jones v. Dodge, 97 Ark. 248, 133 S. W. 828, L. R. A. 1915 A 472; Dorman v. Jacksonville & A. Plank-Road Co., 7 Fla. 265; Macon & A. R. Co. v. Vason, 57 Ga. 314; Whittlesey v. Frantz, 74 N. Y. 456; Nickerson v. English, 142 Mass. 267, 8 N. E. 45; Connecticut & Passumpsic Rivers R. Co. v. Bailey, 24 Vt. 465, 58 Am. Dec. 181; Wilson v. Hundley, 96 Va. 96, 30 S. E. 492, 70 Am. St. Rep. 837.

view is that he may defend against his subscription contract or rescind it.¹²¹ Even though the law will hold the other subscribers to their apparent subscriptions, yet the defrauded subscriber has been misled as to their attitude toward the enterprise.

As a general rule, to constitute fraud for the purpose of avoiding a subscription to stock, as for the purpose of avoiding any other contract, there must be a false representation, and not a mere failure to disclose facts, without more.¹²² A representation, however, which is true as far as it goes, may be rendered false by reason of a failure to disclose facts, or, in other words, may be half-truth only, and in such a case it will amount to fraud. This is true where a prospectus or other statement purports to be a full and fair statement of facts, but conveys a false impression by reason of the suppression of material facts.¹²³

As a general rule, a statement, to constitute a false and fraudulent representation, must be a representation of past or existing fact, and not a mere expression of opinion or prediction.¹²⁴ It is not possible to lay down any hard and fast objective rule as to what

¹²¹ Fraud by fictitious subscriptions. *State Bank v. Cook*, 125 Iowa 111, 100 N. W. 72; *Munson v. Fishburn*, 183 Cal. 206, 190 Pac. 808; *Gilpin v. Netograph Mach. Co.*, 25 Okla. 408, 108 Pac. 382, 29 L. R. A. (N. S.) 447n; 20 Illinois Law Review, 414, 418.

¹²² See *Heymann v. European Cent. Ry. Co.*, L. R. 7 Eq. 154; *Robertson v. Parks*, 76 Md. 118, 24 Atl. 411.

¹²³ See *Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99; *Oakes v. Turquand*, L. R. 2 H. L. 325; *Walker v. Anglo-American Mortgage & Trust Co.*, 72 Hun (N. Y.) 334, 25 N. Y. Supp. 432; *Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. (N. S.) 307.

¹²⁴ *Walker v. Mobile & O. R. Co.*, 34 Miss. 245; *Clem v. Newcastle & D. R. Co.*, 9 Ind. 488, 68 Am. Dec. 653; *Hughes v. Antietam Mfg. Co.*, 34 Md. 316; *Montgomery Southern Ry. Co. v. Matthews*, 77 Ala. 357, 54 Am. Rep. 60; *Shattuck v. Robbins*, 68 N. H. 565, 44 Atl. 694; *Industrial Union v. Lewis*, 174 Wis. 466, 182 N. W. 861.

Representations as to value are almost invariably within this principle, for they are almost necessarily mere expressions of opinion.

While a subscriber may rely upon positive statements of fact as to the financial condition of the company, its ownership of particular property, the nature of its property, its freedom from incumbrance, and other facts affecting the value of its assets and the advantages of the enterprise as an investment, he has no right to rely upon mere expressions of opinion as to the value, present or prospective, of its assets and stock, which from their nature are necessarily speculative. *Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99; *Walker v. Mobile & O. R. Co.*, 34 Miss. 245; *Union Nat. Bank v. Hunt*, 76 Mo. 439; *Robertson v. Parks*, 76 Md. 118, 24 Atl. 411; *Columbia Elec. Co. v. Dixon*, 46 Minn. 463, 49 N. W. 244.

A statement that the property of a corporation cost a certain sum is not a mere expression of opinion, like statements as to value, but is a representation of fact, which, if known to be false, will constitute a false and fraudulent representation. *Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249. See *Sioux City Tire & Mfg. Co. v. Harris* (Iowa), 190 N. W. 142; 3 Wisconsin Law Rev. 346.

kind of representations will be ground of rescission or deceit action and what will not. There is no sharp line between "fact" and "opinion." The buyer cannot rely upon the advice or judgment of the seller. But the seller may be the buyer's only practical source of information as to many matters essential to form an opinion as to value or quality. The question after all is whether the defendant has gone beyond what is legitimate in honest dealing.¹²⁵ If the seller has misled the buyer on points where he could not protect himself from deception and by representations on which the buyer might reasonably rely in making his contract, the buyer should be given redress. A statement of value is an expression of opinion in most instances; but where it is made under conditions which show that it was intended as a basis of action it may become for all practical purposes equivalent to a statement of fact.¹²⁶

A mere collateral promise or a statement of intention, or other statement as to future events, will not ordinarily be ground for rescission. But if such a representation is made with the present intention of not carrying it out it may amount to a misrepresentation of an existing fact.¹²⁷ A mere representation as to the law is no defense or ground of action for all persons are bound to take notice of the law, and have no right to complain if they rely upon such representations.¹²⁸

¹²⁵ *Sawyer v. Prickett*, 19 Wall. (U. S.) 146, 22 L. Ed. 105. A farmer and his wife subscribed for stock and mortgaged their farm on representations that the stock would prove a most lucrative investment and that the road would give a better market for their wheat and would be completed in one year from date. It was held that such opinions and promissory statements are not such representations of fact as are ordinarily a basis for a tort action or for rescission of a contract. But query, in view of superior knowledge of the agent.

¹²⁶ Representation that stock of the corporation is worth full par value when known to be worthless is fraud. *Steele v. Kirven*, 120 S. C. 88, 110 S. E. 837; *Bowe v. Provident Loan Corp.*, 120 Wash. 574, 208 Pac. 22. See *Southern Trust Co. v. Lucas*, 245 Fed. 286; *Haserot v. Keller*, 67 Cal. App. 659, 228 Pac. 383, 388; *Phelps v. Grady*, 168 Cal. 73, 141 Pac. 926; 27 *Yale Law Journal* 338.

¹²⁷ *Bish v. Bradford*, 17 Ind. 490; *Parker v. Thomas*, 19 Ind. 213, 81 Am. Dec. 385; *Armstrong v. Karshner*, 47 Ohio St. 276, 24 N. E. 897; *Richelieu Hotel Co. v. International Military Encampment Co.*, 140 Ill. 248, 29 N. E. 1041, 33 Am. St. Rep. 234; *Hughes v. Antietam Mfg. Co.*, 34 Md. 316; *Columbia Elec. Co. v. Dixon*, 46 Minn. 463, 49 N. W. 244; *City Nat. Bank of Auburn, Ind. v. Mason*, 192 Iowa 1048, 186 N. W. 30.

¹²⁸ *Parker v. Thomas*, 19 Ind. 213, 81 Am. Dec. 385; *Upton v. Tribilcock*, 91 U. S. 45, 23 L. Ed. 203.

For example, a person who has subscribed for stock and received a certificate of stock which on its face renders him liable as a matter of law, for the par value of the stock, cannot avoid liability on the subscription because of false representations by the officers or agents of the corporation that the stock is nonassessable, or that it is only assessable for a certain per cent of the par value, for such representations relate to the legal effect of the

In some jurisdictions it is held that an innocent misrepresentation of a material fact, made by an officer or agent of a corporation with the intention that it shall be relied upon by a subscriber for stock, and which is relied upon, will constitute a fraud in law, for the purpose of rescission, but not for the purpose of an action of deceit, although made without knowledge of its falsity, and without intent to deceive.¹²⁹ In England and some states in this country, however, the rule is different. The representation must have been fraudulent in fact, and therefore it must have been made with knowledge of its falsity, or recklessly and without any knowledge as to whether it was true or false. A representation, according to this view, does not constitute fraud, and is neither ground for an action of deceit, nor ground for rescission, if it was made in good faith, and in the honest belief that it was true, and not recklessly.¹³⁰

In the leading English case of *Derry v. Peek*,¹³¹ the defendants, directors of a company, issued a prospectus stating that the company had the franchise to use steam power on its tramway instead of horses. The plaintiff relying on the representations applied for and was allotted shares in the company. The company proceeded to construct tramways, but could not obtain the right to use steam power and was later wound up. When sued for deceit defendants

subscription and certificate. *Upton v. Tribilcock*, 91 U. S. 45, 23 L. Ed. 203. See 73 *Uni. Pa. Law Rev.* 307. Cf. *Merchants' Realty & Investment Co. v. Kelso*, 46 Cal. App. 218, 189 Pac. 116 (a representation that the stock of a corporation is non-assessable should be held an assurance that the corporation has taken whatever steps are necessary to waive its right to levy assessments, and this representation is one of fact and not of law, which is a defense to action on the subscription.)

¹²⁹ *Farnsworth v. Muscatine Produce & Pure Ice Co.*, 161 Iowa 170, 141 N. W. 940; *Drake v. Fairmont Drain Tile & Brick Co.*, 129 Minn. 145, 151 N. W. 914; *Denis v. Nuway Puncture Cure Co.*, 170 Wis. 333, 175 N. W. 95. See 33 A. L. R. 870 note; 28 *Yale Law Journ.* 178; 30 *Yale Law Journ.* 309. See also, *Williston, Innocent Misrepresentation*, 24 *Harvard Law Rev.* 415.

¹³⁰ *Salem Mill-Dam Corp. v. Ropes*, 9 *Pick. (Mass.)* 187, 19 *Am. Dec.* 363; *Selma, M. & M. R. Co. v. Anderson*, 51 *Miss.* 829; *Cunningham*

v. Edgefield & K. R. Co., 2 *Head (Tenn.)* 23; *Montgomery Southern Ry. Co. v. Matthews*, 77 *Ala.* 357, 54 *Am. Rep.* 60; *American Alkali Co. v. Salom*, 131 *Fed.* 46; *Campbell v. Zion's Co-Op. Home Building & Real Estate Co.*, 46 *Utah* 1, 148 *Pac.* 401; *Burchill v. Hermsmeyer (Tex. Civ. App.)*, 212 *S. W.* 767.

¹³¹ 14 *App. Cas.* 337, 12 *Eng. Rul. Cas.* 250. See *Reno v. Bull*, 226 *N. Y.* 546, 124 *N. E.* 144; *Dwyer v. Redmond*, — *Conn.* —, 130 *Atl.* 108; 12 *Virginia Law Rev.* 76; 30 *Yale Law Journ.* 309. There is a distinction between the fraud that will justify rescission and the wrong that leads to an action of damages for deceit. *Carr v. National Bank & Loan Co.*, 167 *N. Y.* 375, 379, 60 *N. E.* 649, 82 *Am. St. Rep.* 725. By English statute, directors and promoters of companies are made liable to subscribers for untrue statements in prospectuses without proof of actual fraud, unless the defendant can show reasonable ground for believing the statement to be true. Sec. 84 of *Companies (Consolidation) Act, 1908.*

pleaded that they had believed the truth of the assertion and did not know its falsity. It was made *bona fide*, if not with reasonable care. It was held that while those who put before the public a prospectus to induce them to embark their money in a commercial enterprise ought to be vigilant to make their representations in accordance with fact, yet carelessness is not fraud. An action of deceit could not be sustained unless the false statements were made knowingly, or without belief in their truth, or with reckless indifference whether they were true or false. Honest belief is a defense even if there is lack of care in making the representation.

In *Peek v. Gurney*¹³² a company's prospectus concealed and misrepresented certain material facts concerning the enterprise, namely the enormous debts of the old firm whose scheme was adopted by the new company. This misrepresentation was made in order to obtain capital and influence original subscribers. The plaintiff purchased shares from one of the shareholders in the open market on the faith of the prospectus. The defendants who issued the prospectus when sued for deceit pleaded that the prospectus was merely intended as an invitation to subscribe, not to purchase in the open market. This defense was sustained as subsequent purchasers of those shares on the stock exchange were a wider circle than the prospectus was intended to reach. It was not deemed to be addressed to subsequent purchasers.

In order that a subscription may be avoided, or an action of deceit maintained, because of false and fraudulent representations, they must have been addressed to and relied upon by the subscriber. However false and fraudulent a representation may have been, it has no effect unless it constituted a material inducement for the subscription.¹³³ It is not necessary, however, that the representation shall have been the sole inducement. It is enough if it was a material inducement,—if it so contributed as an inducement that without it the subscription would not have been made,—although other inducements may also have contributed.¹³⁴

As a general rule, if a positive representation as to a material fact is made to a person to induce him to subscribe for stock in a

¹³² L. R. 6 H. L. 377, 400. Cf. *Andrews v. Mockford*, L. R. [1896] 1 Q. B. 372.

¹³³ *Pulsford v. Richards*, 17 Beav. 96; *Parker v. Thomas*, 19 Ind. 213, 81 Am. Dec. 385, 390; *Smith v. Tallassee Branch of Central Plank-Road Co.*, 30 Ala. 650; *Weems v.*

Georgia M. & G. R. Co., 88 Ga. 303, 14 S. E. 583; *McEacheran v. Western Transportation & Coal Co.*, 97 Mich. 479, 56 N. W. 860; *National Leather Co. v. Roberts*, 221 Fed. 922.

¹³⁴ *Peek v. Derry*, 37 Ch. Div. 641; *Derry v. Peek*, 14 App. Cas. 337.

corporation, with the intention that he shall rely upon it, and the fact is one as to which the person making the representation can be supposed to have knowledge, the subscriber has a right to rely upon the same, and is not bound to make independent inquiry or investigation to ascertain for himself whether it is true or false; and if a subscription, therefore, is in fact induced by a false and fraudulent representation of fact, the subscriber's right to rescind cannot be resisted by the corporation on the mere ground that he was negligent in relying upon the representation, and that he could have ascertained the truth if he had made inquiry or investigation.¹³⁵

Limitations on the right to rescind for fraud.—A contract of subscription induced by fraud, like other contracts induced by fraud, is not absolutely void, but merely voidable at the option of the subscriber on discovery of the fraud, or within a reasonable time afterwards, and the subscriber, therefore, may ratify the same, or lose his right to rescind by laches or by the intervention of superior equities of third persons.¹³⁶ A man cannot speculate on the success of the company and at the same time reserve the right to withdraw from it on the ground of fraud, and transform himself into a creditor if it fails. A ratification or affirmance of the contract of subscription, with knowledge of the fraud, is a complete and absolute bar to a rescission, and such ratification or affirmance is to be implied if the subscriber, with knowledge of the fraud, acts as a shareholder in the organization of the corporation, or takes part in stockholders' meetings after organization, or acts as an officer, pays assessments, receives dividends, transfers the stock, or does any other act which is inconsistent with an intention to rescind his subscription.¹³⁷

Rescission of a subscription because of false and fraudulent representations ordinarily includes the duty to return or offer to return the certificate of stock if the subscriber has received one

¹³⁵ *Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99; *Upton v. Englehart*, 3 Dill. 496, Fed. Cas. No. 16, 800; *Mead v. Bunn*, 32 N. Y. 275; *McClellan v. Scott*, 24 Wis. 81; *Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249.

¹³⁶ *Oakes v. Turquand*, L. R. 2 H. L. 325; *Howard v. Turner*, 155 Pa. St. 349, 26 Atl. 753, 35 Am. St. Rep. 883, and other cases cited in the notes following.

¹³⁷ *Ex parte Briggs*, L. R. 1 Eq. 483; *Marten v. Paul O. Burns Wine Co.*, 99 Cal. 355, 33 Pac. 1107; *Chaffin v. Cummings*, 37 Me. 76; *Franey v. Wauwatosa Park Co.*, 99 Wis. 40, 74 N. W. 548. See *Rhines v. Skinner Packing Co.*, 108 Neb. 105, 187 N. W. 874 (receipt of dividend not necessarily a ratification of the transaction.)

from the corporation.¹³⁸ But there is no necessity to return or offer to return the certificate, if, at the time the fraud is discovered, a note given in part payment of the subscription has been transferred by the corporation and the stock is of no value.¹³⁹

A subscriber cannot rescind his subscription for fraud, either in equity or at law, if he has been guilty of laches, either in repudiating his subscription after discovery of the fraud, or in discovering the fraud. Or if the rights of creditors would be unduly prejudiced.¹⁴⁰

Effect of insolvency of the corporation.—In general the claims of the creditors are superior to those of stockholders, and it is presumed that a debt contracted after the subscription is contracted in part at least upon the faith of the contribution to capital thereby made. The reason of the rule denying the right to rescind for fraud after his insolvency is the protection of creditors. In England it is held that a subscriber for stock cannot rescind for fraud after the corporation has become insolvent, and it becomes necessary to enforce subscriptions for the benefit of creditors.¹⁴¹ The great weight of authority in this country is to the effect that where

¹³⁸ *Francis v. New York & B. El. R. Co.*, 108 N. Y. 93, 15 N. E. 192; *Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249.

¹³⁹ *Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249.

¹⁴⁰ *First Nat. Reinsurance Co. v. Greenfield*, L. R. [1921] 2 K. B. 260; *Ashley's Case*, L. R. 9 Eq. 263; *Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99; *Weisiger v. Richmond Ice Mach. Co.*, 90 Va. 795, 20 S. E. 361; *Martin v. South Salem Land Co.*, 94 Va. 28, 26 S. E. 591; *Howard v. Turner*, 155 Pa. St. 349, 26 Atl. 735, 35 Am. St. Rep. 883; *Barrows v. Natchaug Silk Co.*, 72 Conn. 658, 45 Atl. 951; *Gress v. Knight*, 135 Ga. 60, 68 S. E. 834, 31 L. R. A. (N. S.) 900; *Reid v. Owensboro Sav. Bank & Trust Co.*, 141 Ky. 444, 132 S. W. 1026.

Whether a subscriber's delay in rescinding his subscription for fraud was unreasonable, so as to constitute laches, depends upon the circumstances, as well as upon the extent of the delay. Even a long delay may not be fatal if satisfactorily explained, and if the circumstances are not such as to render rescission

inequitable. *Central Ry. Co. of Venezuela v. Kisch*, L. R. 2 H. L. 99; *McClellan v. Scott*, 24 Wis. 81; *Zang v. Adams*, 23 Colo. 408, 48 Pac. 509, 58 Am. St. Rep. 249.

¹⁴¹ *Henderson v. Royal British Bank*, 7 El. & Bl. 356; *Oakes v. Turquand*, L. R. 2 H. L. 325, 344. See *Lex v. Selway Steel Corp.*, — Iowa —, 206 N. W. 586, noted in 39 Harvard Law Rev. 773; 41 A. L. R. 674n. See *Milne v. Durham Hosiery Mills, Ltd.*, Ont. [1925] 3 D. L. R. 725 (no action against the company for damages. Only remedy, if available is rescission).

A few American jurisdictions seem to follow the English rule, which makes the institution of insolvency, or winding up proceedings an absolute bar to rescission of a stock subscription on the ground of fraud and to escape from the liabilities arising therefrom. *Commissioner of Banks v. Cosmopolitan Trust Co.*, — Mass. —, 148 N. E. 609, 41 A. L. R. 658, 674, 685 note, on insolvency of corporation as barring stockholder's right to rescind subscription on the ground of fraud.

one has been induced to subscribe to the stock of a corporation through fraudulent representations, and he promptly, upon discovery of the fraud, repudiates the subscription and takes measures to secure rescission, he will not be held as a subscriber.¹⁴² Thus in *Newton Nat. Bank v. Newbegin*,¹⁴³ it is held that the insolvency of the bank before the commencement of plaintiff's action did not preclude him from rescinding his subscription and recovering back the money paid for stock. In a Kentucky case¹⁴⁴ a stockholder in a bank had purchased a part of his stock more than two years before the bank went into liquidation, and a part more than one year before it was insolvent. It was held that he had had ample opportunity to investigate and ascertain the condition of the bank, and take such proceedings as appeared necessary to protect his interests. He neglected to do so, but received dividends on his stock. He was held guilty of laches and not entitled to rescind, as the interests of creditors would thereby suffer injury. If a considerable period of time has elapsed, if the stockholder has actively participated in the affairs of the corporation, and if there has been any want of diligence in discovering the fraud or in taking steps to rescind when fraud was discovered, or if any considerable amount of indebtedness has been created subsequent to the subscription and in presumable reliance upon it, the right of rescission may be lost entirely or subordinated to creditors.

It has been held by some courts that as to those creditors whose claims arose after the subscriber had become a stockholder, the right of the rescinding subscriber is subordinate to the claims of the creditors in the distribution of assets. The claims of subsequent depositors and creditors are held paramount to those of defrauded stockholders.¹⁴⁵

¹⁴² *Gress v. Knight*, 135 Ga. 60, 68 S. E. 384, 31 L. R. A. (N. S.) 900; *Stone v. Walker*, 201 Ala. 130, 77 So. 554, L. R. A. 1918 C 839; *Green v. Stone*, 205 Ala. 381, 87 So. 862; *Morrisey v. Williams*, 74 W. Va. 636, 82 S. E. 509, L. R. A. 1915 D 792; *Stalnaker v. Gum*, 87 W. Va. 283, 104 S. E. 730. See 22 Harvard Law Rev. 58; 24 Harvard Law Rev. 147; 37 Harvard Law Rev. 767. The great majority of American cases hold that insolvency of the corporation does not in and of itself cut off the right of the defrauded stockholder to escape his liabilities, except in combination with laches or

some other element of estoppel. See 41 A. L. R. 689n; 46 A. L. R. 484n.

¹⁴³ 74 Fed. 135, 33 L. R. A. 727. See *In re Recording Devices Co.*, 1 Fed. (2d) 474 (right to rescind and prove a claim in bankruptcy for money paid in absence of facts creating estoppel.)

¹⁴⁴ *Reid v. Owensboro Sav. Bank & Trust Co.*, 141 Ky. 444, 132 S. W. 1026. See *Bartlett v. Stephens*, 137 Minn. 213, 163 N. W. 288, noted 5 Minn. Law Rev. 219.

¹⁴⁵ *Lamb v. Bonesteel*, 186 Iowa 971, 173 N. W. 13; 5 Iowa Law Bulletin 59 (victim of fraud must bear the burden in preference to subse-

§ 44a. **Effect of stock watering as against innocent subscribers.**—In the absence of an express provision or agreement to the contrary, persons who have become stockholders in a corporation by subscribing for or purchasing shares, and paying or agreeing to pay for them, have a right to assume that other stockholders have come in on the same terms, and contributed or agreed to contribute a like amount of capital in proportion to their shares, and they also have a right to expect that subsequent subscribers or purchasers will come in on the same terms. Any secret agreement, therefore, between the officers of the corporation and subscribers or purchasers of shares, although authorized or ratified by a majority of the stockholders, by which such subscribers or purchasers have been permitted to acquire their shares without payment, or on part payment only, or by which they are given the right to withdraw and receive back what they have paid, is a fraud upon subsequent *bona fide* subscribers or purchasers, and void as to them. And if the corporation refuses to enforce full payment, or repays what has been paid in, they may maintain a suit in equity on behalf of themselves and other stockholders to compel payment in full or repayment of what has been withdrawn.¹⁴⁶ If a corporation is about to issue stock without receiving payment in full, in viola-

quent creditors misled by his act); *Grand Rapids Trust Co. v. Geer*, 233 Mich. 577, 207 N. W. 883 (defense of fraud is postponed to claims of subsequent creditors who relied on note as capital asset); *Green v. Stone*, 205 Ala. 381, 87 So. 862; *In re Recording Devices Co.*, 1 Fed. (2d) 474; *In re Morris Bros., Inc.*, 282 Fed. 670; *Van Gilder v. Eagleson*, 66 Colo. 364, 181 Pac. 539; *Gress v. Knight*, supra, 142n. See *Stalnacker v. Gum*, 87 W. Va. 283, 104 S. E. 730; *Farmers' State Bank of Mobridge v. Empey*, 35 S. D. 107, 150 N. W. 936.

In Burningham v. Burke, — Utah —, 245 Pac. 977, 983, 46 A. L. R. 466; it is said, as to the acquisition of priority by subsequent creditors over defrauded subscribers: "The difficult question is: May he do so (rescind) when a considerable amount of indebtedness has been incurred by the corporation subsequent to the stock subscription or purchase and before the insolvency of the company or the appointment of the receiver? The authorities as to this also are in

conflict. Independent of other evidence, or other facts or circumstances, it is rare where, from the mere fact of a stock subscription or purchase and the incurring of corporate indebtedness thereafter, a conclusive presumption may be indulged that such debt or debts were incurred on reliance of stock subscription or purchase. To give a subsequent creditor equities over a defrauded stockholder, it is not essential that it be shown by direct evidence that the creditor or creditors relied on the stock subscription or purchase; but, to justify such reliance, there ought to be shown some facts or circumstances in addition to the mere fact that a substantial amount of debt was incurred or credit given subsequent to the stock subscription or purchase."

¹⁴⁶ *Melvin v. Lamar Ins. Co.*, 80 Ill. 446, 22 Am. Rep. 199; *White Mountains R. Co. v. Eastman*, 84 N. H. 124; *Morawetz, Corporations* (2d Ed.), § 286. See post, § 50, note 78.

tion of the common-law rights of stockholders, or in violation of a charter, statutory, or constitutional provision, a dissenting stockholder may maintain a suit in equity on behalf of himself and other stockholders to enjoin it from doing so.¹⁴⁷

May innocent shareholders, who have paid full value for their shares, sue either in their own behalf or in a representative suit to cancel stock which has been issued for an inadequate or fictitious consideration? Some courts hold that the issue of watered or fictitiously paid up stock may operate as a fraud upon other persons who subscribe for or purchase shares in the corporation, and pay for the same in full, so as to entitle them to sue in equity to cancel the stock or to compel payment in full.¹⁴⁸ Other courts, however, refuse to grant relief by way of cancellation, even where the control of the company is left in the hands of those who acquired most of the common stock gratuitously and have given nothing to the company. The relief decreed may be simply to hold such stock assessable by the corporation for the balance unpaid and make each share show what had been paid thereon.¹⁴⁹

When a corporation has issued its stock as full-paid, without receiving its par value in money or property, the transaction cannot be assailed by stockholders who participated, consented, or acquiesced. They are estopped.¹⁵⁰ And a stockholder who does

¹⁴⁷ Donald v. American Smelting & Refining Co., 62 N. J. Eq. 729, 48 Atl. 771, 1116 (injunction at instance of dissenting shareholders against issue of increased stock for property worth less than the face value of the stock).

¹⁴⁸ Melvin v. Lamar Ins. Co., 80 Ill. 446, 22 Am. Rep. 199; Fitzpatrick v. Dispatch Pub. Co., 83 Ala. 604, 2 So. 727; Fisk v. Chicago, R. I. & P. R. Co., 53 Barb. (N. Y.) 513; Pollitz v. Wabash R. Co., 207 N. Y. 113, 100 N. E. 721; Taylor v. Citizens' Oil Co., 182 Ky. 350, 206 S. W. 644; Parsons v. Joseph, 92 Ala. 403, 8 So. 788; Perry v. Tuskaloosa Cotton-Seed Oil Mill Co., 93 Ala. 364, 9 So. 217; Gilman, C. & S. R. Co. v. Kelly, 77 Ill. 426; Kimball v. New England Roller Grate Co., 69 N. H. 485, 45 Atl. 253; Essex v. Essex, 141 Mich. 200, 104 N. W. 622; Frame v. Mahoney, 21 Ariz. 282, 187 Pac. 584 (under Const. 1910, art. 14, sec. 6); 31 Yale Law Journal 883.

¹⁴⁹ No cancellation of watered stock. Scully v. Automobile Finance Co., 12 Del. Ch. 174, 109 Atl. 49; Soule v. Kunkle, 71 Colo. 221, 205 Pac. 529; s. c., 68 Colo. 524, 190 Pac. 536; Whitewater Tile & Pressed Brick Mfg. Co. v. Johnson, 171 Wis. 82, 175 N. W. 786; Winters v. Lindsay, 52 Cal. App. 93, 198 Pac. 43 (hearing denied by supreme court.)

¹⁵⁰ In re Charles Town Light & Power Co., 199 Fed. 846; Wood v. Corry Water-Works Co., 44 Fed. 146, 12 L. R. A. 168; Washburn v. National Wall-Paper Co., 81 Fed. 17; Nierosi v. Calera Land Co., 115 Ala. 429, 22 So. 147; Winston v. Dorsett Pipe & Paving Co., 129 Ill. 64, 21 N. E. 514, 4 L. R. A. 507; Green v. Abietine Medical Co., 96 Cal. 322, 31 Pac. 100; Woolfolk v. January, 131 Mo. 620, 33 S. W. 432; Ten Eyck v. Pontiac, O. & P. A. R. Co., 114 Mich. 494, 72 N. W. 362; Wisner v. Delhi Land & Improvement Co., 46 La. Ann. 1223, 15 So. 690; Knoop v.

not object within a reasonable time, when he has knowledge of the transaction, will be deemed to have acquiesced.¹⁵¹

By the weight of authority, a transferee of stock in a corporation occupies the same position as his transferrer with respect to the right to complain of an issue of watered or fictitiously paid up stock, and is therefore estopped to complain if his transferrer was estopped. This is true, whether he is a transferee of shares of the watered stock, or a transferee of shares of other stock, which was held by a participating or consenting stockholder; and it is true notwithstanding the fact that he purchased the stock in good faith and in ignorance of the fraudulent or unlawful issue.¹⁵² The liability of subscribers and their transferees of watered or fictitiously paid up stock to creditors of the corporation is considered in a subsequent section.¹⁵³

Bohmrich, 49 N. J. Eq. 82, 23 Atl. 118; Vasey v. New Export Coal Co., 89 W. Va. 491, 109 S. E. 619; Soule v. Kunkle, 71 Colo. 221, 205 Pac. 529.

¹⁵¹ Taylor v. South & North Alabama R. Co., 13 Fed. 152; Keeney v. Converse, 99 Mich. 316, 58 N. W. 325.

¹⁵² Wood v. Corry Water-Works Co., 44 Fed. 146, 12 L. R. A. 168; Higgins v. Lansingh, 154 Ill. 301, 40 N. E. 362; Callanan v. Windsor, 78 Iowa 193, 42 N. W. 652; Clark v.

American Coal Co., 86 Iowa 436, 53 N. W. 291, 17 L. R. A. 557; Barr v. New York, L. E. & W. R. Co., 125 N. Y. 263, 26 N. E. 145; Drake v. New York Suburban Water Co., 26 N. Y. App. Div. 499, 50 N. Y. Supp. 826; Walburn v. Chenault, 43 Kan. 352, 23 Pac. 657; contra, Parsons v. Joseph, 92 Ala. 403, 8 So. 788. See also, post, § 192.

¹⁵³ Post, § 210; Jose v. Utley, 185 Cal. 656, 199 Pac. 1037; Bowen v. Imperial Theatres, 13 Del. Ch. 120, 115 Atl. 918.

CHAPTER V.

PROMOTERS, THEIR CONTRACTS AND LIABILITY FOR FRAUD.

§ 45. Promotion defined.

What is promotion?—Promotion is a term of somewhat vague content which covers the operations of those who find business schemes and investment enterprises, who interest capitalists in the project and organize them into a corporation to take over the project and assist in procuring subscriptions and plant until the new corporation is fully launched in business.¹ The term “promoter” is defined in *Old Dominion Copper Mining & Smelting Co. v. Bigelow*² as including “those who undertake to form a corporation and to procure for it the rights, instrumentalities and capital by which it is to carry out the purposes set forth in its charter, and to establish it as fully able to do business. Their

¹ *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600. See also, *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 35 Atl. 436, aff'd 56 N. J. Eq. 411, 41 Atl. 1115, and modified 58 N. J. Eq. 556, 43 Atl. 671; *Bosher v. Richmond & H. Land Co.*, 89 Va. 455, 16 S. E. 360, 37 Am. St. Rep. 879. Compare *St. Louis, Ft. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 15 Pac. 544; *Arnold v. Searing*, 78 N. J. Eq. 146, 78 Atl. 762, 766; *Richlands Oil Co. v. Morriss*, 108 Va. 288, 61 S. E. 762; *The Telegraph v. Loetscher*, 127 Iowa 383, 101 N. W. 773, 4 Ann. Cas. 667; *Bigelow v. Old Dominion Copper Mining & Smelting Co.*, 74 N. J. Eq. 457, 501, 71 Atl. 153; *Gates v. Megargel*, 266 Fed. 811, 816. See *Isaacs*, 38 Harvard Law Rev. 887, 890; 14 C. J. 252, 253; A. S. Dewing, *Financial Policy of Corporations* (6th Ed.), vol. 2, for an account of the function of promoters.

In *Wheeler & Motter Mercantile Co. v. Lamerton*, 8 Fed. (2d) 957, it is said: “The authority or agency

granted to the cosigners is limited to the performance of the acts necessary to perfect the organization of the corporation. Nor does the fact that one signs and verifies the articles of incorporation and subscribes for capital stock in a proposed corporation make him a promoter thereof, within the legal significance of that equivocal and ambiguous term in cases of this character. *Benton v. Minneapolis Tailoring & Mfg. Co.*, 73 Minn. 498, 76 N. W. 265, 267; *Farmers' State Bank v. Kuchs*, 163 Mo. App. 606, 147 S. W. 862; *Mitchell v. Jensen*, 29 Utah 346, 81 Pac. 165; *Rutherford v. Hill*, 22 Ore. 218, 29 Pac. 546, 17 L. R. A. 549, 29 Am. St. Rep. 596.”

² 203 Mass. 159, 177, 89 N. E. 193, 40 L. R. A. (N. S.) 314. It is said that so long as there are prospective original subscribers for stock and the promoters remain in control, the fiduciary relation will continue. *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

work may begin long before the organization of the corporation, in seeking the opening for a venture and projecting a plan for its development, and may continue after the incorporation by attracting the investment of capital in its securities and providing it with the commercial breath of life."

§ 46. Liability of corporations on contracts of promoters.—A corporation is neither liable upon, nor entitled to enforce, contracts made on its behalf by its promoters before incorporation, unless it expressly or impliedly adopts the same; but, by the weight of authority, it may expressly or impliedly adopt such contracts, and thus make them its own, after incorporation.

Promoters of a corporation are not its agents, and cannot contract for it. A corporation, therefore, when it has been organized, and has thus acquired corporate existence, is not liable upon a contract made by its promoters, or by agents appointed by them, before its organization, even though the contract may have been made in its name, and with the understanding that it would perform the same, unless it has expressly or impliedly adopted the same since its organization, or unless liability is imposed upon it by its charter or by statute.³ Neither can the corporation enforce a contract made by its promoters in its behalf. In *Penn Match Co. v. Hapgood*,⁴ it was alleged in the declaration that A, B and C agreed to form the plaintiff corporation and applied to the defendants in the name of and for the benefit of the proposed corporation for certain machinery that could be obtained only from the defendants; that thereupon defendants agreed with A, B and C, in the name of the projected company, to furnish it with certain machinery and materials. In reliance on this agreement a factory was built for the corporation which was duly organized and now sues on the contract. It was held on demurrer that the declaration alleged a contract made before the corporation had a legal existence, and did not show any contract to which the plaintiff was a

³ *Penn Match Co. v. Hapgood*, 141 Mass. 145, 7 N. E. 22; *Abbott v. Hapgood*, 150 Mass. 248, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. Rep. 193; *Kirkup v. Anaconda Amusement Co.*, 59 Mont. 469, 197 Pac. 1005, 17 A. L. R. 441, 452; *Battelle v. Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. 327; *Weatherford, M. W. & N. W. Ry. Co. v. Granger*, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837;

⁴ 141 Mass. 145, 7 N. E. 22. The Virginia Law Rev. 525; 3 Cornell Law Quart. 292; 18 Columbia Law Rev. 275; Alger, Law of Promoters, p. 199.

⁴ 141 Mass. 145, 7 N. E. 22. The promoters were allowed to recover on the same contract. *Abbott v. Hapgood*, 150 Mass. 248, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. Rep. 193. See *Cassidy v. Rose*, 108 Okla. 282, 236 Pac. 591.

party. No action therefore could be maintained by the corporation upon the agreement made in its behalf by the promoters. It may be noted that there was no allegation of acceptance or adoption of the contract by the plaintiff corporation after its incorporation, and also that the right of a third party beneficiary to sue on a contract is not recognized in Massachusetts. The law confers no power upon the promoters or organizers of a corporation to enter into preliminary contracts which shall bind the corporation when it comes into existence without its consent. Such contracts may bind the individuals who make them and if adopted may become the contracts of the corporation also.

§ 47. Adoption or ratification of contract by the corporation.

In England it has been held that, in the absence of a charter or statutory provision, a contract made by the promoters of a corporation on its behalf before incorporation binds only the promoters, and that the corporation cannot ratify or adopt it, and thus make it binding upon it, after incorporation. The leading case is *Kelner v. Baxter*,⁵ which was an action against the promoters of a hotel company for the price of goods sold for the use of the company. The offer to sell the goods was made to A, B and C "on behalf of" the proposed company and accepted by them on its behalf. The understanding seems to have been that when the company came into existence it would adopt the contract. The goods were handed over to the company and consumed by it in the hotel business. It was held that the defendants A, B and C having had no principal who could be bound originally were themselves bound. Willes, J., said: "Could the company become liable by a mere ratification? Clearly not. Ratification can only be by a person ascertained at the time of the act done—by a person in existence. * * * Both upon principle and authority, therefore, it seems to me that the company never could be liable upon this contract, and we must

⁵ L. R. 2 C. P. Cas. 174. The case illustrates two points of English Law: (1) A corporation is not liable upon a contract made by its promoters in its behalf before the incorporation, even though it later takes the benefit of the contract. (2) There is no exemption from personal liability upon the part of the promoters, although they contract on behalf of the corporation. See 34 Harv. Law Rev. 290, Warren. The argument was apparently not made that the contract contemplated a

novation of the corporation in place of the promoters by which they would be released. See also, *In re Empress Engineering Co.*, 16 Ch. Div. 125; *North Sydney Investment & Tramway Co. v. Higgins*, [1899] App. Cas. 263; *In re Johannesburg Hotel Co.*, [1891] 1 Ch. 119; *Bagot Tyre Co. v. Clipper Tyre Co.*, [1902] 1 Ch. 146, [1904] App. Cas. 120; *Natal Land Co. v. Pauline, Ltd.*, 52 Ont. L. R. 315, [1923] 3 Dom. Law Rep. 1110.

assume that the parties contemplated that the persons signing it should be personally liable." This view has also been taken by the supreme court of Massachusetts.⁶

In other states, however, the English doctrine has been repudiated, and it has been held that a contract made by the promoters of a corporation on its behalf may be adopted by the corporation when organized, and that the corporation is then liable, both at law and in equity, *on the contract itself*, and not merely for the benefits received.⁷ Thus in a Minnesota case⁸ property was acquired by plaintiff, one of the organizers of the defendant company, at the request of two other promoters, and was conveyed to the corporation in pursuance of a preliminary agreement that when formed, the corporation should assume and pay the mortgage to which the property was subject. It was held that the corporation adopted the contract by taking the property.

The ratification or adoption by a corporation of a contract made by its promoters need not necessarily be by formal vote of the stockholders or directors, but it may be implied from any conduct on the part of its stockholders or officers, such as acceptance of the benefits of the contract with knowledge of the facts, which shows an intention to adopt and be bound by the contract. Formal action by the stockholders or directors is necessary only where it would be necessary to a similar original contract.⁹ Thus, if the board of directors or other officers of a corporation, having authority to bind it by contracts, recognize as binding upon the corporation a contract made on its behalf by its promoters before in-

⁶ *Abbott v. Hapgood*, 150 Mass. 248, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. Rep. 193. Compare the dictum in *Penn Match Co. v. Hapgood*, 141 Mass. 145, 7 N. E. 22. See *Koppel v. Massachusetts Brick Co.*, 192 Mass. 223, 78 N. E. 128; *Whiting & Sons Co. v. Barton*, 204 Mass. 169, 90 N. E. 528.

⁷ *New England Oil Co. v. Wiltsee*, 3 Fed. (2d) 424; *Gardiner v. Equitable office Bldg. Corp.*, 273 Fed. 441, 17 A. L. R. 431; *Stanton v. New York & E. Ry. Co.*, 59 Conn. 272, 22 Atl. 300, 21 Am. St. Rep. 110; *Western Screw & Mfg. Co. v. Cousley*, 72 Ill. 531; *Battelle v. Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. 327; *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep.

653; *Scadden Flat Gold-Mining Co. v. Scadden*, 121 Cal. 33, 53 Pac. 440; *Weatherford, M. W. & N. W. Ry. Co. v. Granger*, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837; *Morgan v. Bon Bon Co.*, 222 N. Y. 22, 118 N. E. 205.

⁸ *Battelle v. Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. 327. See 19 Harvard Law Rev. 97; 33 Yale Law Journal 203; 18 Columbia Law Rev. 275.

⁹ *Gardiner v. Equitable Office Bldg. Corp.*, 273 Fed. 441, 17 A. L. R. 431, 461n; *Battelle v. Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89, 33 N. W. 327; *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653; *Morgan v. Bon Bon Co.*, 222 N. Y. 22, 118 N. E. 205.

corporation, such recognition will amount to a ratification or adoption of the contract, whether it is expressed orally, or in a letter, or otherwise, or implied from conduct.¹⁰ Mere silence or failure to object, however, when a contract or claim is mentioned, is not such a ratification as will bind the corporation.^{10a} But if the promoters of a corporation, before its organization, enter into a contract for its benefit, with the understanding, expressed or implied, that the contract will be adopted and performed by the corporation, and the corporation, after it is organized, accepts the benefit of the contract with knowledge of the facts, it is bound to perform the same, for its conduct in accepting the benefit of the contract is an implied adoption of its obligations.¹¹

The better opinion, however, is that the contract must have been made on behalf of the company, and with the understanding that it would adopt and be bound by it.¹² If the promoter purchases goods or employs one to perform services on his own credit, the mere fact that the corporation receives the benefit of them is not an adoption by the corporation. Adoption is assent to an arrangement made in contemplation of the corporation assuming the contract, as ratification is the adoption of an act of one who purported to act as agent of another.

Theories of liability.—If a contract has been made between the promoter and the third party it is difficult to see how the corporation may make itself a party to it by mere adoption. The corporation might assume the burdens of the contract by agreement with the promoter upon sufficient consideration. But this assumption would give it no right to sue, which it could only claim by assignment or as a beneficiary. Mere assent to the contract or

¹⁰ *Schreyer v. Turner Flouring Mills Co.*, 29 Ore. 1, 43 Pac. 719; *United German Silver Co. v. Bronson*, 92 Conn. 266, 102 Atl. 647. Express adoption is by vote or resolution of the directors. Implied adoption is by acts or conduct, as by the receipt and retention of benefits, which it might reject. *Stanton v. New York & E. Ry. Co.*, 59 Conn. 272, 22 Atl. 300, 21 Am. St. Rep. 110.

^{10a} *Kirkup v. Anaconda Amusement Co.*, 59 Mont. 469, 197 Pac. 1005, 17 A. L. R. 441.

¹¹ *Seymour v. Spring Forest Ceme-*

tery Ass'n, 144 N. Y. 333, 39 N. E. 365, 26 L. R. A. 859; *Weatherford, M. W. & N. W. Ry. Co. v. Granger*, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837; *Oakes v. Cattaraugus Water Co.*, 143 N. Y. 430, 38 N. E. 461, 26 L. R. A. 544; *Morgan v. Bon Bon Co.*, 222 N. Y. 22, 118 N. E. 205. Acceptance of services with full knowledge of contract with organizers is an assumption of obligations.

¹² *Little Rock & Ft. S. R. Co. v. Perry*, 37 Ark. 164; *Rockford, R. I. & St. L. R. Co. v. Sage*, 65 Ill. 328, 16 Am. Rep. 587.

promise to assume it would not bind the corporation unless the other elements of a contract were present. Four theories have been advanced as to how the liability of the corporation upon promoters' contracts may arise: (1) Ratification; (2) adoption; (3) continuing offer accepted; (4) novation, or some other new contract by the corporation based upon a mutual agreement of all the parties. It is sometimes said that what is called adoption is in legal effect the making of a new contract at the date of adoption, but nothing more seems to be required than would be necessary to the ratification of the act of an unauthorized agent done in the name or on behalf of a corporation, viz., assent, confirmation or recognition. The theory of ratification¹³ is criticised by text-writers and courts on the somewhat technical ground that "ratification" presupposes an existing person on whose behalf the contract might have been made at the time.¹⁴ But where a contract is made in the name of or for and on behalf of a contemplated corporation the approval or confirmation by the corporation is very similar in requisites and effect to the ratification of the acts of an unauthorized agent, and it does not seem important to call it an adoption rather than a ratification.¹⁵

When it is said that a corporation may thus adopt or ratify a contract made by its promoters on its behalf, it is not meant that it may ratify the contract in the sense that a person may ratify a contract made by another as his agent without authority, so as to render it binding as of the time when it was made. There can be no ratification in this sense, for when the promoters enter into the contract there is no corporation for which they can act as agents.

In a Minnesota case^{15a} it is held that the date of adoption is the time when the contract is to be regarded as made for the purpose of determining whether it is to be performed within a year from the making thereof, so as not to be within the statute

¹³ See note to *Kirkup v. Anacanda Amusement Co.*, 59 Mont. 469, 197 Pac. 1005, 17 A. L. R. 441, at p. 458.

¹⁴ Ratification implies existence of principal at time of contract. *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653; *Pittsburg & T. Copper Min. Co. v. Quintrell*, 91 Tenn. 693, 20 S. W. 248. Compare, however, *Stanton v. New York & E. Ry. Co.*, 59 Conn. 272, 22 Atl. 300, 21 Am. St.

Rep. 110; *Schreyer v. Turner Flouring Mills Co.*, 29 Ore. 1, 43 Pac. 719.

¹⁵ It has been said that "whatever would amount to a ratification of the unauthorized acts of an agent would be sufficient evidence of the adoption of the contracts of a promoter." *Arapahoe Inv. Co. v. Platt*, 5 Colo. App. 515, 518, 39 Pac. 584.

^{15a} *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653.

of frauds. The contract of the corporation does not "relate back" to the date of the contract with the promoter. But this doctrine of relation back is a mere fiction, and does not seem an essential feature of the idea of ratification which is the subsequent affirmance of an act of another, done while purporting to act as agent. Even though the promoters cannot be regarded as agents of the future corporation, yet when they have assumed to contract on its behalf the approval or confirmation of such acts will have substantially the same effect as the ratification of the acts of an unauthorized agent, except for the purpose of relating back and except possibly for that of releasing the promoters from liability.

What is the nature of adoption?—If the corporation adopts the agreement of the promoters it becomes a corporate contract as much as though originally authorized while the corporation was in existence. Adoption, like ratification, may be shown by any words or acts of responsible officers showing assent or approval, by accepting the benefits of the contract, by proceeding to perform or suing to enforce it. The question remains, how can a third person make himself a party to a contract by adoption? One theory is similar to that frequently relied on with reference to preliminary stock subscriptions, that the original contract is in the nature of a continuing proposal, which the corporation may accept.¹⁶

It is said in some cases that the adoption of such a contract is nothing more or less than the making of a new contract.¹⁷ If all parties contemplate that the corporation when formed shall take over the contract made by the organizers, and the corporation assents, it might well be considered a novation by which it is substituted in the place of the promoters.¹⁸

¹⁶ *Kirkup v. Anaconda Amusement Co.*, 59 Mont. 469, 197 Pac. 1005, 17 A. L. R. 441: "The adoption of such a contract is on the theory that the contract made by the promoters is a continuing offer. . . . and that it may be accepted and adopted by the corporation after it is created."

Promoter's contract regarded as proposal to corporation. *Stone v. Walker*, 201 Ala. 130, 77 So. 554, L. R. A. 1918C 839; *Pratt v. Oshkosh Match Co.*, 89 Wis. 406, 62 N. W. 84. See *Mechem, Agency* (2nd Ed.), sec. 383. There are two diffi-

culties with this theory: (1) that to treat the promoter's contract as an offer to the corporation is artificial, and (2), the conduct from which adoption is inferred is not such as would ordinarily be regarded as communication of an acceptance of an offer.

¹⁷ *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653; *Kridelbaugh v. Aldrehn Theatres Co.*, 195 Iowa 147, 191 N. W. 803.

¹⁸ *I Williston, Contracts*, sec. 306. See *O'Rorke v. Geary*, 207 Pa. 240, 56 Atl. 541; 14 C. J. 282.

Connected contracts.—It has been held, in a leading Texas case¹⁹ that a corporation, in accepting the benefit of a contract made by its promoters, does not necessarily adopt previous contracts connected with the contract the benefit of which it accepts, and that, in accepting the benefits of a particular contract, the corporation, while it adopts all the obligations imposed by that contract, does not adopt and become liable upon a promise of its promoters in a previous contract to pay for services in procuring the contract the benefits of which are accepted. In the case referred to, a railroad company accepted bonus subscriptions raised by its promoters from certain individuals under a contract by which it was agreed that the corporation should build its road between certain points, and carry coal at a certain rate. It was held that the corporation, in accepting the bonus subscriptions, adopted the contract under which the bonus was paid, and became bound to fulfill the stipulations of that contract,—to build the road between certain points, and carry coal at a certain rate,—but that it did not thereby adopt the previous contract by the promoters to pay the plaintiff for his services in procuring the bonus.

The action was brought by Granger, an attorney at law, for services rendered in procuring a bonus and for legal services rendered both before and after incorporation. Plaintiff was employed by Anderson, the promoter of the corporation. A proposition was made on behalf of the company by its promoter that if a bonus of \$40,000 should be subscribed and paid to it, it would build a railroad between certain points and would carry coal at a certain rate. The issue raised is whether one employed by a promoter to get subscriptions or raise a bonus and render legal services for the benefit of the corporation, becomes entitled to the compensation promised by the promoter if the company avails itself of his services and takes the benefit thereof by accepting the

¹⁹ *Weatherford, M. W. & N. W. Ry. Co. v. Granger*, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837, rev'g 23 S. W. 425.

It is a serious question whether the distinction drawn by the court is sound, that the company did not take the benefit of the prior contract between the promoter and the plaintiff by accepting and taking the benefit of the subscription contracts procured by the plaintiff. It

is said that one may sometimes get the benefit of work done by another without being liable to pay for it; but query whether this is true where you have notice of his expectation to be compensated by you when you accept the benefit. See *Chilcott v. Washington State Colonization Co.*, 45 Wash. 148, 88 Pac. 113; *Maryland Apartment House Co. v. Glenn*, 108 Md. 377, 70 Atl. 216. See also, note 4 Brit. Rul. Cas. 748.

subscriptions. It was held that by accepting the bonus, the company became bound to fulfill the stipulations of the contract with the bonus subscribers. That was the burden it took with the benefit of the agreement. But the promise of the promoter to compensate the plaintiff for his services in procuring subscriptions to the bonus was no part of the contract, the benefits of which were taken by the company. A corporation does not by accepting a bonus from subscribers on its organization become liable on the contract of the promoter to pay the solicitor for his services in procuring the bonus. It may be doubted whether this is a sound distinction, between the acceptance of the benefits of the bonus contract, and the benefit of the prior contract between the promoter and the plaintiff by availing itself of the bonus contract.

§ 47a. Liability of promoters on contracts adopted by the corporation.—The promoters of a corporation are personally liable upon contracts made by them before incorporation, although made on behalf of the corporation, in the absence of an understanding to the contrary, unless they are released from liability. The mere adoption of the contract by the corporation does not release them unless a novation is contemplated.

A promoter, in making business arrangements on behalf of a proposed corporation may (1) obtain offers for the corporation which may be accepted by it upon incorporation; (2) make a contract binding himself with a stipulation that after the company is formed and assents to the contract, he shall be relieved of responsibility; (3) bind himself personally and look to the proposed corporation when formed to adopt the contract and indemnify him.²⁰ When promoters of a projected corporation enter into a contract before its organization, their liability on the contract will depend upon the terms of the contract and the intention of the parties. They are not personally liable if it is understood that the other party shall look to the corporation only, when it is formed. The contract may be made solely on behalf of the cor-

²⁰ In *O'Rourke v. Geary*, 207 Pa. 240, 56 Atl. 541, it was said that a promoter acting for a proposed corporation cannot bind it by anything which he does at the time, but he may (1) take an offer for the proposed corporation, which may be accepted by it; (2) make a contract

at the time binding himself with a stipulation that after a company is formed, it will take his place and then he shall be relieved of responsibility; (3) bind himself personally and look to the proposed corporation when formed to adopt or assume the contract and indemnify him.

poration, and credit may be extended solely to it, though in the process of formation.²¹

Generally, however, persons dealing with promoters are given the double security of the promoters in the first instance and the corporation when it comes into existence and assents to the contract. Promoters are frequently held personally liable where the language used is such as would bind only the corporation, if the corporation were then in existence. In a leading English case *A, B and C*, promoters, obtained an offer to sell them a stock of wines, addressed to them on behalf of the proposed *G Hotel Co.* The offer was accepted by them on behalf of the company, and in pursuance of the agreement the goods were delivered to the company and consumed by it in the business of the hotel. It was held that *A, B and C* who had no principal who could be bound originally, became themselves bound, and oral evidence that it was never intended that the promoters should be personally liable was inadmissible as varying the written contract.²²

When a promoter binds himself personally by a contract, the subsequent adoption or assumption of the contract by the corporation, when organized, will not relieve him from liability, even though the corporation may thereby become liable, unless the other party to the contract consents, so that there is a novation; for it is a well-settled principle of the law of contracts that a party to a contract cannot relieve himself from its obligations by the substitution of another person, without the consent of other party.²³ It has been pointed out, however, that contracts with promoters might be fairly interpreted as contemplating a novation, and that

²¹ *Carle v. Corhan*, 127 Va. 223, 103 S. E. 699; *In re Heckman's Estate*, 172 Pa. St. 185, 33 Atl. 552; *Davis v. Joerke*, 47 N. D. 39, 181 N. W. 68; it may be that the only liability intended to be evidenced by the contract was whatever liability the corporation would later assume and that the solicitors of subscriptions relied exclusively upon the corporation to be formed for compensation and expenses. See 33 Harv. Law Rev. 110; 38 Harv. Law Rev. 887, 898; 40 Harvard Law Rev. 780; 12 Cornell Law Quart. 192; 36 Yale Law Journ. 709.

²² *Kelner v. Baxter*, L. R. 2 C. P. 174; *Roberts Mfg. Co. v. Schlick*, 62 Minn. 332, 64 N. W. 826. See *Harrill v. Davis*, 168 Fed. 187, 22

L. R. A. (N. S.) 1153; cf. *Davis v. Joerke*, 47 N. D. 39, 181 N. W. 68.

²³ *Kelner v. Baxter*, L. R. 2 C. P. 174; *Queen City Furniture & Carpet Co. v. Crawford*, 127 Mo. 356, 30 S. W. 163; *Chapin v. Longworth*, 31 Ohio St. 421; *Strause v. Richmond Woodworking Co.*, 109 Va. 724, 65 S. E. 659, 132 Am. St. Rep. 937. The tendency of the courts is to adhere to the doctrine that those dealing with promoters should be left with the double security of the promoter and the corporation when it is formed, unless it clearly appears that no liability of the promoter was intended, or that he was to be released when the liability of the corporation was assumed.

the third parties may be held to have contracted in advance to take the corporation in the place of the promoters. If the corporation when formed adopts the contract, this should then be a defense to the promoters.²⁴ So if, on the adoption by a corporation of a contract made by its promoters, it is agreed between all the parties that the corporation alone shall be liable, and the promoters released, there is a novation, the release of the promoters is supported by a sufficient consideration, and no action will afterwards lie against them on the contract.²⁵ Such an agreement may be implied from the conduct of the parties.²⁶ So, when a contract is made with the promoters of a corporation with the understanding at the time that it is to be assumed by the corporation when formed, and the corporation is formed and the contract assumed by it, the other party cannot hold the promoters personally liable on the contract.²⁷

§ 48. Liability of corporation for promotion services and expense of organization.—A corporation is not liable, by the weight of authority, for services and expenses of its promoters in organization, unless made so by its charter. But it becomes bound to pay for them by an express promise to pay for them after incorporation, or by taking benefits under a contract only partly performed prior to incorporation.

It has been held in some states that, if the promoters of a corporation necessarily perform services or incur expenses, as, for example, in procuring preliminary subscriptions to the capital stock, with the expectation that they shall be compensated, and such services were necessary and reasonable, a promise to pay by the corporation, after its organization and acceptance of the bene-

²⁴ I Williston, Contracts, p. 580; 14 C. J. "Corporations," §§ 312, 314; Warren, 34 Harvard Law Rev. 290.

In Chicago Bldg. & Mfg. Co. v. Talbotton Creamery & Mfg. Co., 106 Ga. 84, 31 S. E. 809, it is held that where the corporation assumes the contract, the right of action against the organizers who made the contract ceases. It was intended that the right of the party should be against the corporation which was to be formed to carry out the enterprise contemplated by the contract. The corporation when created was to take the place of the individuals who had agreed to form it. Com-

pare Queen City Furniture & Carpet Co. v. Crawford, 127 Mo. 356, 30 S. W. 163.

²⁵ Van Vlieden v. Welles, 6 Johns. (N. Y.) 85. And see Shields v. Clifton Hill Land Co., 94 Tenn. 123, 28 S. W. 668, 26 L. R. A. 509, 45 Am. St. Rep. 700; Irwin Glass Co. v. Buchanan, 289 Fed. 348.

²⁶ Van Vlieden v. Welles, 6 Johns. (N. Y.) 85.

²⁷ In re Heckman's Estate, 172 Pa. St. 185, 33 Atl. 552; Chicago Bldg. & Mfg. Co. v. Talbotton Creamery & Mfg. Co., 106 Ga. 84, 31 S. E. 809; Smith v. Parker, 148 Ind. 127, 45 N. E. 770; see Chieppo v. Chieppo, 88 Conn. 233, 90 Atl. 940.

fits of such services or expenses, will be implied.²⁸ The better opinion and the weight of authority, however, is to the effect that there is no such liability on the part of the corporation to its promoters, in the absence of an express promise by it after its organization, unless, as is sometimes the case, such a liability is imposed by its charter or by the general law.²⁹ An express promise to pay, by the corporation after its organization, is on a sufficient consideration, and is binding upon it without any new consideration.³⁰

In *Kridelbaugh v. Aldrehn Theatres Co.*³¹ an action was brought to recover \$1,500, the value of legal services in the incorporation of the defendant company and expenses incurred at the request of the promoter in its creation. It was held that the mere user of the charter and by-laws by the defendant was not an adoption of the promoter's contract. The court, however, found a recognition by the board of directors that the plaintiff was to be paid for past services in the organization of the company as well as for the services which he was to perform, namely in obtaining a permit to sell stock. In *Morgan v. Bon Bon Co.*³² four men made a contract for the organization of a corporation. It was agreed that M, the plaintiff, should receive 25 shares of stock in the proposed company in payment for services in putting into operation a system of bookkeeping for the corporation which was to be organized. The next day the corporation was organized and all of its stock was

²⁸ *Low v. Connecticut & Passumpsic Rivers R. Co.*, 45 N. H. 370; *s. c.*, 46 N. H. 284; *Hall v. Vermont & M. R. Co.*, 28 Vt. 401; *Farmers' Bank of Vine Grove v. Smith*, 105 Ky. 816, 49 S. W. 810, 88 Am. St. Rep. 341. See *Machen, Corporations*, secs. 338, 340, 361.

²⁹ *In re English & Colonial Produce Co.*, 2 Ch. Div. 435, 4 Brit. Rul. Cas. 748; *Melhado v. Porto Algere, N. H. & B. Ry. Co.*, L. R. 9 C. P. 503; *New York & N. H. R. Co. v. Ketchum*, 27 Conn. 170; *Rockford, E. I. & St. L. R. Co. v. Sage*, 65 Ill. 328, 16 Am. Rep. 587; *Gardiner v. Equitable Office Bldg. Corp.*, 273 Fed. 441, 17 A. L. R. 431; *Cushion Heel Shoe Co. v. Hartt*, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. (N. S.) 979. See 17 A. L. R. 481n.

³⁰ See *Western Screw & Mfg. Co. v. Cousley*, 72 Ill. 531; *Franklin Fire Ins. Co. v. Hart*, 31 Md. 59;

Smith v. New Hartford Water Co., 73 Conn. 626, 48 Atl. 754; *Royal Casualty Co. v. Puller*, 194 Mo. App. 588, 186 S. W. 1099; *Hart-Toole Furniture Co. v. Shahan* (Tex. Civ. App.), 220 S. W. 181. See 34 Harv. Law Rev. 288; *United German Silver Co. v. Bronson*, 92 Conn. 266, 102 Atl. 647, noted in 31 Harv. Law Rev. 894.

³¹ 195 Iowa 147, 191 N. W. 803. See 11 Minnesota Law Rev. 465.

³² 222 N. Y. 22, 118 N. E. 205. See 18 Columbia Law Rev. 275n. *McLaughlin*, Justice, dissented on the ground that the contract with the promoter did not purport to bind the corporation or to have been executed on its behalf. There was nothing to show corporate action of any kind. This action was upon the agreement to issue stock and not to recover for the value of the services rendered.

issued to the four organizers. After this M performed for the corporation the services above indicated with the knowledge of the officers of the corporation, which, however, refused to deliver the shares of stock. It was held that the evidence showed that the corporation had adopted the contract made by its organizers with the plaintiff and had become bound by it.

§ 49. **Fiduciary obligation of promoters.**—Promoters come into a fiduciary relation to the corporation and toward subscribers to its stock, which demands of them the utmost good faith in their dealings, and they cannot retain secret profits made by manipulation of the company while under their control or influence. The fiduciary relation, like that of directors and officers, is based on the position of power over the affairs of others which gives an opportunity to make personal gains at their expense. There are four principal methods by which a promoter may satisfy his fiduciary duty, and make a personal transaction with the corporation valid and binding: (1) a full disclosure to an independent board of officers of all the material circumstances; (2) a disclosure to each original subscriber; (3) a ratification of the contract by the stockholders of a completely established corporation; (4) by becoming the real subscriber to all the authorized stock, or all that it is contemplated to issue as part of the promotion scheme.

The promoter is a self-constituted agency for launching the corporation in business. He usually has in his hands the power of deciding how and when it shall begin to act as a business concern. His control is so great that it involves correlative responsibility, from which arises the fiduciary relation of the promoter toward the company and those who contribute its capital. This fiduciary relation, while often compared to that of an agent or trustee, is a peculiar one and not so strict as that of one supposed to be entirely disinterested. Persons engaged in promotion usually expect to receive and seek to obtain in return for their initiative, labor and risk, a liberal reward in the shape of securities and other forms of profit. Objection is ordinarily raised to the compensation which they have taken when the enterprise has proved unsuccessful and the promoters are then called upon to make proof of sufficient disclosure.³³

³³ Ehrich on Promoters, sec. 130; Isaacs, *The Promoter: A Legislative Problem*, 38 *Harv. Law Rev.* 887,

894, 898. "The fiduciary theory has both its advantages and its limitations."

Important questions arise as to what profits the promoter may take, how he may obtain legitimate rewards for services rendered and risks incurred, and what remedies are available in behalf of a cheated corporation or its stockholders in case of the promoter selling land, options, or patents at exorbitant prices in stock or money to be paid by future stockholders. The promoter is entitled to reap some reward for his labors in discovering the possibilities of a new enterprise and in organizing a company to take it over. He has to buy in his own right and then sell the property to the corporation. He has to take the expense and risk of the transaction at the outset. Some profit may justly be allowed him for his services and for bearing the risk, even if he is a fiduciary and not a stranger free to deal at arm's length with the corporation. He is not precluded from dealing with the corporation, but any transaction to be valid must be fair and fully disclosed to the corporation or beneficiary, which must be put in a position to protect its own interests. This is an obligation resting upon every fiduciary who makes a sale of his own property to the beneficiary, such as a trustee, guardian, agent, or the director or promoter of a corporation. The promoter may sell his property to the corporation at a profit, but in order to make the contract binding, it seems that his duty requires one of the following precautions: "(1) He may provide an independent board of officers in no respect directly or indirectly under his control, and make full disclosure to the corporation through them. (2) He may make full disclosure of all material facts to each original subscriber of shares in the corporation. (3) He may procure a ratification of the contract after disclosing the circumstances, by vote of the stockholders of the completely established corporation. (4) He may himself be the real subscriber of all the shares of the capital stock contemplated as part of the promotion scheme."³⁴

³⁴ *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 203 Mass. 159, 89 N. E. 193, 40 L. R. A. (N. S.) 314. See *Erlanger v. New Sombrero Phosphate Co.*, 3 App. Cas. 1236, 6 Eng. Rul. Cas. 794, per Cairns L. C.: "I do not say that the owner may not promote and form a joint stock company, and then sell his property to it, but I do say that if he does he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise

an independent and intelligent judgment on the transaction and who are not left under the belief that the property belongs not to the promoter, but to some other person."

In *re Jubilee Cotton Mills, Ltd.*, [1924] A. C. 958; [1923] 1 Ch. 1; 91 L. J. Ch. 777, 39 L. Q. R. 159; 97 Cent. Law Journ. 295. Disclosure to a board, the members of which are themselves participants in promotion profits is not valid. Disclosure must be made to an independent board or body of stock-

Accountability for secret profits.—Judge Severens remarks in *Yeiser v. United States Board & Paper Co.*³⁵ that the concoction of schemes is too frequent in which the promoter “may take an option or a conditional contract for the purchase of property, and then turn it over, at a profit to himself to a corporation to be organized, and to be under his control for a sufficient time to enable him to realize the fruits of the enterprise.” The position of the promoter is peculiarly open to abuse, especially in connection with sales to the new corporation.

Properly speaking, the promoters of a projected corporation cannot be said to be its agents in any sense; but they are in a position analogous to that of an agent. Their relation to the persons who become subscribers to stock, and to the proposed corporation when formed, is a fiduciary relation, and for this reason it is well settled that they will not be permitted to take advantage of their position in order to make a secret profit out of their transactions on behalf of the proposed corporation or of the corporators, or out of their dealings with the corporation or subscribers. If they do so, they will not be allowed to retain their advantage or gain, but the transaction may be set aside in equity, or they may be compelled to account or be held liable to respond in damages.³⁶

holders who are free to act upon the information for the benefit and protection of the company as a whole. Ehrich on Promoters, chap. 7, sec. 109ff. All of these methods rest in final analysis upon the same basis, that of adequate disclosure and acquiescence or consent of those concerned.

³⁵ 107 Fed. 340, 52 L. R. A. 724. In *See v. Heppenheimer*, 69 N. J. Eq. 36, 52, 74, 61 Atl. 843, Pitney, V. C., remarked: “This transaction is known, in the language employed in these financial transactions as ‘getting in on the ground floor.’ . . . It was hoped and expected that the common stock would receive periodical dividends for a period of time long enough at least to enable some, if not all, of it to be marketed, or, to use the apt phrase which has been applied . . . ‘to be distributed to’ and later to be ‘digested by the public.’”

³⁶ *Erlanger v. New Sombbrero Phosphate Co.*, 3 App. Cas. 1218, aff'g *New Sombbrero Phosphate Co. v. Erlanger*, 5 Ch. Div. 73; *Chand-*

ler v. Bacon, 30 Fed. 538; *Yale Gas Stove Co. v. Wileox*, 64 Conn. 101, 29 Atl. 303, 25 A. L. R. 90, 42 Am. St. Rep. 159; *Nebraska Mausoleum Co. v. Matters*, 108 Neb. 618, 188 N. W. 231; *American Forging & Socket Co. v. Wiley*, 206 Mich. 664, 173 N. W. 515; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 35 Atl. 436, aff'd 56 N. J. Eq. 411, 41 Atl. 1115, and modified 58 N. J. Eq. 556, 43 Atl. 671; *Arnold v. Searing*, 78 N. J. Eq. 146, 78 Atl. 762; *Brewster v. Hatch*, 122 N. Y. 349, 25 N. E. 505, 19 Am. St. Rep. 498; *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. St. 202, 100 Am. Dec. 628; *Central Land Co. of Buchanan v. Obenchain*, 92 Va. 130, 22 S. E. 876; *Bosher v. Richmond & Harrisonburg Land Co.*, 89 Va. 455, 16 S. E. 360, 37 Am. St. Rep. 879; *Pittsburg Min. Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149. See also, *In re Olympia* [1898] 2 Ch. 153; *Lagunas Nitrate Co. v. Lagunas Syndicate* [1899] 2 Ch. 392.

While the company is under the promoter's control or under his influence, he owes it something the same duty not to take advantage of it in selling his property or services or obtaining its securities that a trustee owes his beneficiary not to take advantage of his position, or a director or other officer of a corporation. To render a promoter of a corporation thus liable to account for secret profits, it is not necessary to show that there was a fraudulent intent on his part. It is enough if the profits were made secretly, and without the consent of the corporators.³⁷ This principle applies when a person purchases property while acting as a promoter of a corporation, or buys an option to purchase the same, and then sells it to the corporation at an advance, misrepresenting or concealing the price paid by him. In such a case he perpetrates a fraud upon the corporation and the other stockholders, and may be compelled to disgorge his secret profits in the transaction.³⁸ The principle also applies where a person who owns property, or has an option to purchase property, promotes a corporation for the purpose of selling to it, and misrepresents or conceals the price paid by him in order to effect the sale, or obtains stock in return for it without disclosing to the stockholders the true value.³⁹ So if a person act as a promoter in organizing a

³⁷ Woodbury Heights Land Co. v. Loudenslager, 55 N. J. Eq. 78, 35 Atl. 436; aff'd 56 N. J. Eq. 411, 41 Atl. 1115, and modified 58 N. J. Eq. 556, 43 Atl. 671; Pittsburg Mining Co. v. Spooner, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149; Chandler v. Bacon, 30 Fed. 538; Lagunas Nitrate Co. v. Lagunas Syndicate [1899] 2 Ch. 392.

In the same way "the relations of the president and directors to the corporation are fiduciary to a high degree. The interest of the beneficiary—the corporation and its stockholders—is confided to their care. In that relationship they must be guided solely by their honest and disinterested judgment. They must not place self-interest above the welfare of the corporation. . . . There must be the fullest disclosure (of personal interest), the utmost good faith, and no secret profits." Morris, J., in *Hodgman v. Atlantic Refining Co.*, 300 Fed. 590, 594.

³⁸ *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. St. 202, 100 Am. Dec. 628; *Pittsburg Min. Co. v. Spooner*,

74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 35 Atl. 436, aff'd 56 N. J. Eq. 411, 41 Atl. 1115, and modified 58 N. J. Eq. 556, 43 Atl. 671; *Brewster v. Hatch*, 122 N. Y. 349, 25 N. E. 505, 19 Am. St. Rep. 498; *Bosher v. Richmond & Harrisonburg Land Co.*, 89 Va. 455, 16 S. E. 360, 37 Am. St. Rep. 879; *Victor Oil Co. v. Drum*, 184 Cal. 226, 193 Pac. 243. Defendants through the medium of a corporation induced a number of persons to associate with them for the purchase of certain properties for prices greater than necessary to obtain them, and without any disclosure of that fact or that the defendants expected to harvest the difference in price, and had an interest in the purchase adverse to the association, and would profit out of moneys which their associates would contribute. The corporation was entitled to the secret profits realized in excess of the option price.

³⁹ *Erlanger v. New Sombrero Phosphate Co.*, 3 App. Cas. 1218,

corporation to purchase a patent or other property from a third person, and receives a part of the purchase money, or a commission, under a secret agreement with the vendor, he must account for it to the corporation.⁴⁰

In *Gluckstein v. Barnes*,⁴¹ suit was brought for a secret profit of £20,000 made in selling property to the company. The prospectus disclosed the original purchase price, but did not show the profit of the £20,000 made in buying up the charges on the property. This latter fact was concealed from the persons who became stockholders, but, being eventually discovered, suit was brought by the official receiver of the company to recover the £20,000. The suit was sustained by the House of Lords, upon the ground that the promoters had been, from the time of their original purchase of the property, acting in a fiduciary relation to the company to which they proposed to convey it, and that the profit belonged to the company. Lord Macnaghten said:

"It is the old story. It has been done over and over again. . . . These gentlemen set about forming a company to pay them a handsome sum for taking off their hands a property which they had contracted to buy with that end in view. They bring the company into existence by means of the usual machinery. They appoint themselves sole guardians and protectors of this creature of theirs, half-fledged and just struggling into life, bound hand and foot while yet unborn by contracts tending to their private advantage, and so fashioned by its makers that it could only act by their hands and only see through their eyes. They issue a prospectus representing that they had agreed to purchase the property for a sum largely in excess of the amount which they had, in fact, to pay. On the faith of this prospectus they collect sub-

aff'g 5 Ch. Div. 73; *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate*, [1899] 2 Ch. 392; *Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444; *Pittsburg Min. Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149; *Getty v. Devlin*, 54 N. Y. 403; s. c., 70 N. Y. 504; *Geiser v. United States Board & Paper Co.*, 107 Fed. 340, 52 L. R. A. 724 (secret profit in sale of manufacturing plant to corporation; stock of promoters canceled to extent of \$25,000, which was obtained without paying for it.) See note on liability of promoter of corporation formed to purchase specific property for a profit made by

him in the transaction in 8 Brit. Rul. Cas. 907.

⁴⁰ *Bagnall v. Carlton*, 6 Ch. Div. 371; *Emma Silver Min. Co. v. Grant*, 11 Ch. Div. 918; *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159; *Central Land Co. v. Obenchain*, 92 Va. 130, 22 S. E. 876; *Chandler v. Bacon*, 30 Fed. 538; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 35 Atl. 436, aff'd 56 N. J. Eq. 411, 41 Atl. 1115, and modified 58 N. J. Eq. 556, 43 Atl. 671.

⁴¹ [1900] App. Cas. 240.

scriptions from a confiding and credulous public. And then comes the last act. Secretly, and therefore dishonestly, they put into their own pockets the difference between the real and the pretended price. After a brief career the company is ordered to be wound up."

Persons who conspire with promoters of a corporation to induce it to purchase property at a certain price, upon the representation that it is a reasonable price, and the one which has been agreed to be paid to the owner, whereas it is greatly in excess of the sum agreed to be paid, are, equally with the promoters, liable for the secret profits made on the sale of the property to the corporation, although it is not alleged that such persons, other than the promoters, had any dealings with the corporation or its members, or occupied fiduciary relations towards them, or made false representations to the stockholders, or knew that any were made. This is on the well-established principle that "where several persons combine to carry out a fraudulent conspiracy to cheat another, each and all of such persons are liable to the defrauded party, without reference to the amount of the fruits of the fraudulent transaction he obtains or the degree of his activity in the scheme."⁴²

When promoter may take a profit.—The rule that a promoter of a corporation cannot make a profit in selling property to the corporation only applies where he acts, or assumes to act, on behalf of the corporators or the proposed corporation, or where, for some other reason, there is a fiduciary relation between him and the corporation or the members of the corporation.⁴³ It does not apply when a person who has acted as one of the promoters of a corporation deals with it, through its duly-authorized officers or agents, after its organization, and sells it property owned by him, but not purchased when acting as promoter. And it can make no difference in such a case that he was one of the promoters, or the sole promoter, of the corporation, and does not, in selling it, inform

⁴² *American Shipbuilding Co. v. Commonwealth S. S. Co.*, 215 Fed. 296; *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 66 N. W. 119, 52 L. R. A. 209, 53 Am. St. Rep. 917; *Lomita Land & Water Co. v. Robinson*, 154 Cal 36, 97 Pac. 10, 18 L. R. A. (N. S.) 1106. All persons co-operating in a fraud inducing a corporation to purchase property at

a price in excess of that agreed to by the owner are liable equally with the promoters for the secret profits, although they may not share in the profits of the fraud.

⁴³ *Richardson v. Graham*, 45 W. Va. 134, 30 S. E. 92; *St. Louis, Ft. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 15 Pac. 544, and other cases in the note following.

the officers of the corporation of the price which he paid for it.⁴⁴ If, however, a promoter purchases⁴⁵ or obtains an option to purchase property⁴⁶ with the purpose of conveying it to a corporation being organized, or transacts other business with the corporation, he is under a duty to make a full disclosure⁴⁷ of his interest and of all material facts to an independent board of directors of the corporation, over whom he exerts no control, or to all the stockholders of the corporation.⁴⁸ If he fails to make such disclosure, he must account to the corporation for secret profits realized upon the transaction. Upon the question whether the duty of disclosure of original cost exists where the promoter was owner of the property before he assumed the functions of a promoter, the courts are not entirely in accord. Some courts have held that in such a case the promoter may sell the property to the corporation for any price he can secure, provided only that he makes no false representations.⁴⁹ On principle, the better view is that there must be

⁴⁴ *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43; *Central Land Co. v. Obenchain*, 92 Va. 130, 22 S. E. 876; *Milwaukee Coal Storage Co. v. Dexter*, 99 Wis. 214, 74 N. W. 976, 40 L. R. A. 837; *St. Louis, Ft. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 15 Pac. 544; *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219, 27 Atl. 1094; *Richardson v. Graham*, 45 W. Va. 134, 30 S. E. 92.

⁴⁵ *In re Leeds and Hansley Theatres*, [1902] 2 Ch. 809, 823, 831; 3 *Cook, Corporations* (8th Ed.), sec. 651, p. 2445 et seq.

⁴⁶ *Victor Oil Co. v. Drum*, 184 Cal. 226, 234, 193 Pac. 243; *Mississippi Lumber Co. v. Joice*, 176 Ill. App. 110, 118 et seq.; *Parker v. Boyle*, 178 Ind. 560, 566 et seq., 99 N. E. 986; *Wills v. Nehalem Coal Co.*, 52 Ore. 70, 79 et seq., 96 Pac. 528; *Pittsburg Min. Co. v. Spooner*, 74 Wis. 307, 320 et seq., 42 N. W. 259, 17 Am. St. Rep. 149; notes, 18 L. R. A. (N. S.) 1106, 1114; 25 L. R. A. 90, 92; 1 *Fletcher, Corporations* (1st Ed.), sec. 138; 3 *Cook Corporations* (8th Ed.), sec. 651, p. 2438 et seq.; *Ehrich, Promoters*, sec. 115, p. 223.

⁴⁷ A disclosure which on further investigation will reveal the profits made, is not sufficient. *Nebraska Mausoleum Co. v. Matters*, 108 Neb. 618, 626, 627, 188 N. W. 231; *Arnold*

v. Searing, 78 N. J. Eq. 146, 160, 78 Atl. 762. Contra, *Brooker v. William H. Thompson Trust Co.*, 254 Mo. 125, 160-161, 162 S. W. 187.

⁴⁸ In allowing a recovery of the profits, the fact that the option or property was purchased with the funds paid in by innocent subscribers is sometimes stressed. The purchase, it is said, is made for the corporation, *Wills v. Nehalem Coal Co.*, 52 Ore. 70, 80, 96 Pac. 528; *Parker v. Boyle*, 178 Ind. 560, 566, 99 N. E. 986, especially where the promoter designates himself as trustee for the corporation in making the purchase, *Mississippi Lumber Co. v. Joice*, 176 Ill. App. 110, 118, or where the purchase is made by the promoter as trustee for the subscribers and the property is conveyed to the corporation when organized. *American Shipbuilding Co. v. Commonwealth S. S. Co.*, 215 Fed. 296, 299.

⁴⁹ *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43, 49 et seq. (see footnote 8); *Milwaukee Cold Storage Co. v. Dexter*, 99 Wis. 214, 228 et seq., 74 N. W. 976, 40 L. R. A. 837. But if false representations are made to the subscribers, a right of action is recognized in the corporation. *Burbank v. Dennis*, 101 Cal. 90, 99 et seq., 35 Pac. 444; 3 *Wisconsin Law Rev.* 442.

a disclosure,⁵⁰ for if the promoter's relationship to the corporation forbids the making of a secret profit, the method by which it is obtained, whether by the sale of property previously owned by him, or by the sale of property purchased from another, should be immaterial. And the time of acquiring the property should be equally immaterial if his fiduciary relationship did exist at the time of the sale to the corporation.⁵¹

In *Densmore Oil Co. v. Densmore*⁵² three owners of certain oil property which they had acquired and developed with no idea of forming a company, decided to promote a corporation to take over the property. They employed the other defendants as solicitors to obtain subscriptions to the stock. They took payment for the land partly in cash and the balance in stock, and from this stock compensated the solicitors for their services. The price which they obtained was found to be fair and reasonable, but they did not disclose the original cost or the profit that they were making. It was held that they stood in no confidential relation to the company and were not liable to account for profits. This distinction was drawn by Sharswood, J.: "Any man or number of men, who are the owners of any kind of property, real or personal, may form a partnership or association with others, and sell the property to the association at any price that may be agreed upon between them, no matter what it may have originally cost, provided there is no fraudulent misrepresentation made by the vendors to their associates. They are not bound to disclose the profit which they made by the transaction." But if the vendors have already begun to promote the company, "it is not competent for them to purchase property for the purpose of such a company and then sell it at an advance without a full disclosure of the facts."

It is suggested by Machen⁵³ that the true ground of this often-

⁵⁰ *Erlanger v. New Sombrero Phosphate Co.* [1878] L. R. 3 App. Cas. 1218, 1236, 1269, 1283 et seq., aff'g L. R. 5 Ch. Div. 73, 112 et seq. See *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 188 Mass. 315, 322, 74 N. E. 653, 108 Am. St. Rep. 479.

⁵¹ Taylor, *Private Corporations* (2nd Ed.), sec. 83, p. 52; Alger, *Promoters* (1st Ed.), p. 30, footnote 2. It has been suggested that the case of *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43, 49 et seq. (see also, p. 52) might be supported on its facts since it does not appear that the

property was sold to the corporation for more than its actual value. 1 Machen, *Corporations*, sec. 384, p. 321; Alger, *Promoters*, sec. 30. See 8 Minnesota Law Rev. 540.

⁵² 64 Pa. St. 43. See *Victor Oil Co. v. Drum*, 184 Cal. 226, 234, 193 Pac. 293; *Henderson v. Plymouth Oil Co.* (Del. Ch.), 131 Atl. 165; s. c. 136 Atl. 140. See 3 Wisconsin Law Rev. 442.

⁵³ 1 Machen, *Corporations*, sec. 384. See 1 *Fletcher, Corporations*, sec. 136; *Ex-Mission Land Co. v. Flash*, 97 Cal. 610, 32 Pac. 600.

quoted decision was not that there was no fiduciary relation or duty of disclosure, but that in fact no profit was made at the expense of the corporation as the land was well worth the full price paid for it, and the corporation had no right to the benefit of the original purchase prior to the promotion.⁵⁴ It is sufficient if the terms are fair and just.

§ 50. Effect of assent of all existing stockholders at time of transaction as bar to corporate right of action against fraudulent promoters.

There is a conflict of authority whether there is any corporate right of action or rescission where promoters obtain secret profits by unloading property on the corporation at an excessive valuation, and where later, as was intended, stock is sold to subsequent subscribers without disclosure of the transaction, if it was assented to by all the existing subscribers and stockholders.

There are four different classes of cases in which the manipulation of promoters must be considered:

- (1) Cases in which the promoter obtains a secret profit and makes disclosure at the time of sale only to a group in control. There are innocent existing stockholders at the time.
- (2) Cases where the promoter discloses his scheme to all the existing stockholders, but there is authorized unissued stock which the promoter and his confederates intend to have the corporation dispose of to future innocent subscribers without disclosure.
- (3) Cases where the promoters take all the authorized stock themselves for property at an overvaluation, not intending that stock shall be issued by the corporation to future subscribers, but intending to sell their own stock on the market without disclosure, or to have the corporation sell it as treasury stock.

⁵⁴ The measure of profit where the promoter owned the property is the difference between the actual value of the property and the price at which it was conveyed. 7 R. O. L. 78; *Roberson v. Draney*, 53 Utah 263, 276 et seq., 178 Pac. 35; 1 *Machen, Corporations*, sec. 384, p. 322. Where the promoter purchases with the intention to sell to the cor-

poration being organized, the measure of profit is the difference between the price at which it was purchased and the price at which it was conveyed to the corporation. *Victor Oil Co. v. Drum*, 184 Cal. 226, 237, 193 Pac. 243; *Moore v. Warrior Coal & Land Co.*, 178 Ala. 234, 242, 59 So. 219, Ann. Cas. 1915B 173.

- (4) Cases where the organizers intended in good faith to retain their stock and to manage the company as a closed corporation without inviting the public to subscribe, but later cause the corporation to take in new subscribers without disclosure of overvaluation of patents, etc.

If promoters organize a corporation and take a large part of the authorized stock in exchange for a transfer of property, paying much less than the par value of the stock, and then induce subsequent subscribers to take stock in ignorance of the transaction, paying full par value therefor into the corporate treasury, by the weight of authority, the corporation has a right of action to rescind or to hold the promoters accountable for secret profits, notwithstanding the consent of all stockholders at the time of the transfer. The federal courts and some state courts, however, hold that if there is any right of action, it belongs to the defrauded subsequent subscribers individually and not to the corporation.

It is an important and disputed question whether there is a corporate right of action against the promoter if he and his associates are owners of all the issued stock at the time of the act complained of, although intending as part of their plan the immediate issue of further stock to the public without disclosure, and a fraud on future subscribers is the great object of their scheme of promotion.⁵⁵ Granting that there is a fraud on individual subscribers, can we find any basis for a corporate right of action?

The argument is a plausible one that inasmuch as those who participated in the transaction constituted the entire corporation at the time, the corporation itself must be deemed to have assented, and that a subsequent subscriber or purchaser of stock cannot demand that the corporation recover from the organizers the profits so made. But there are strong arguments that promoters should not be able to escape liability to the corporation where they conspire against future subscribers and make a secret profit by placing the corporate securities on the market after watering the

⁵⁵ *Ball v. Chapman*, 1 Fed. (2d) 895; *Ball v. Breed, Elliott & Harrison*, 294 Fed. 227. Receiver cannot recover secret promotion profits, \$1,100,000 excess price paid to the bankers, for options and properties, where the promoters and conspirators owned all the stock subscribed for and there were no innocent stockholders, since there was no

fraud on the corporation, citing *Old Dominion Copper Mining & Smelting Co. v. Lewisohn*, 210 U. S. 206, 52 L. Ed. 1025, 28 Sup. Ct. 634. The cause of action is personal to the purchasers of the stock. See *Ehrich on Promoters*, sec. 120; 8 Minn. Law Rev. 520; 24 Columbia Law Rev. 542.

stock. There are several different situations arising from various methods of manipulation by which the promoter issues securities or obtains an unfair advantage in return for property sold to the corporation:

1. Cases where the promoter at the time of the sale makes disclosure only to a group in control who are in league with his scheme, and there are at the time innocent stockholders or subscribers interested in the enterprise.

2. Cases where the promoter discloses his scheme to all existing stockholders and subscribers, but the plan is to gain advantage by inducing subsequent subscribers to come in without disclosure.

3. Cases where the promoters take the entire authorized issue of stock for grossly overvalued property, and then sell their own stock on the market without disclosure, or else donate part back to the corporation for sale as treasury stock so that they will share in the benefit by the stock which they retain.

4. Cases where the organizers have no fraudulent intent at the time of transfer, but make a transfer on terms known to all concerned at the time, and then later take in new subscribers without disclosure of the prior overvaluation and stock watering.

There is a radical difference of opinion as to the promoter's liability to suit brought by the corporation if the contract or stock issue or transfer is made when the corporation is composed of shareholders entirely conversant with the transaction. Where no intention exists to issue stock to outsiders, the English rule is that the corporation may not sue to recover the profits when new stockholders are later brought in.⁵⁶ The United States Supreme Court has refused to permit recovery by the corporation even where the fraudulent intention of bringing in new stockholders existed, provided full disclosure was made to all members of the corporation at the time of the transaction.⁵⁷ On the same state of facts, however, the Massachusetts court held the promoter liable to suit by the corporation to recover secret profits.⁵⁸ If any existing stockholders or subscribers are kept in ignorance of the trans-

⁵⁶ *In re British Seamless Paper Box Co.* [1881] L. R. 17 Ch. D. 467.

⁵⁷ *Old Dominion Copper Mining & Smelting Co. v. Lewisohn*, 210 U. S. 206, 216, 52 L. Ed. 1025, 28 Sup. Ct. 634: "The plaintiff cannot recover without departing from the fundamental conception embodied in the law that created it; the concep-

tion that a corporation remains unchanged and unaffected in its identity by changes in its members."

⁵⁸ *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 203 Mass. 159, 89 N. E. 193, 40 L. R. A. (N. S.) 314; s. c., 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479. See a criticism of this case in 30

action and disclosure is made only to a group in control of the corporation, the courts have uniformly held that the corporation has a right of action to recover secret profits.

In *Pittsburgh Min. Co. v. Spooner*,⁵⁹ the defendants procured an option to purchase certain mining rights for \$20,000. They then proceeded to obtain subscriptions for the shares of stock of a proposed company which was to be formed to purchase the mining rights. They represented to subscribers that the price demanded by the owners of the mining rights was \$90,000, and that the property could not be bought for less; that they, the defendants, were themselves desirous of purchasing, but were unable to pay so much money, and had therefore determined to organize a corporation to make the purchase; that they would become subscribers for stock to the extent of their ability; that there was no speculation in the purchase price; that they were making nothing out of it—not even their expenses, unless the corporation, when formed, should see fit to reimburse them—except what all stockholders would make alike, through the mining operations to be carried on by the corporation; and that \$100,000 was required in the enterprise, \$90,000 for the purchase of the mining rights from the owners and \$10,000 to work the mines.

The defendants then caused a subscription paper to be drawn up, by the terms of which subscribers agreed with the defendant Main, who was described as the owner of the mining rights, to take the number of shares in the Pittsburgh Mining Company, “proposed to be formed,” set opposite their respective names, and to pay for the same \$2.50 per share as soon as the company was incorporated. The capital of the company was to be \$100,000 divided into 40,000 shares of \$2.50 each.

The defendants then organized the plaintiff company, being the sole incorporators. Upon the organization, Main subscribed for all the stock, with the exception of two shares subscribed for by the defendants Spooner and Oakley. At the same time, a vote was passed by the defendants, as the sole incorporators and directors, authorizing the issue of the shares subscribed for by Main to him

Harvard Law Rev. 39, by R. D. Weston; Little, *Promoter's Frauds*, 5 Illinois Law Rev. 87.

⁵⁹ 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149. Facts are given here as summarized in Alger on Promoters, sec. 57, p. 62. It appears that there was no real sale to the

corporation until nearly all the stock was subscribed and that the money to make the purchase was furnished by the subscribers. The secret profit of \$70,000 was paid from money received from the sale of the stock, which was thus diverted from the corporate treasury by fraud and manipulation. There

or to such persons as he might designate, upon his transfer of the mining rights to the company. The mining rights were then transferred by the owners to Main, and by Main were transferred to the company.

The shares subscribed for by Main were issued to the persons who had agreed with him to take shares, and \$100,000 was paid by them therefor to the company. The defendants from this sum paid the original owners of the mining rights \$20,000, kept \$10,000 in the treasury, and divided the remaining \$70,000 among themselves. It was held that they must account to the company for the \$70,000 as secret profit to which the company was entitled. Although the defendants were the only members of the corporation at the time of the purchase, the subscribers were the real parties in interest, and in fact received their stock direct from the corporation. The transfer to Main of the stock for the option was nominal and fictitious.

In *Davis v. Las Ovas Co., Inc.*,⁶⁰ it is held that there is a right of action in the corporation itself against promoters guilty of fraud, if there are at the time innocent stockholders or subscribers who are ignorant of the scheme to make a secret profit. "The standing of the corporation results from the fact that there were innocent and deceived members of the corporation when the property was taken over by it." Recovery by the corporation is not defeated by the fact that it will inure to the benefit of the guilty as well as the innocent members. An injury to the corporation has thus readily been found by all courts in the ordinary case where at the time of the transaction there were innocent stockholders who did not know of the profit.⁶¹ A wrong to the cor-

was thus an injury to the corporation and it was the proper complainant.

⁶⁰ 227 U. S. 80, 57 L. Ed. 426, 427, 33 Sup. Ct. 197. In 26 Columbia Law Rev. 447, 451, it is said that the effect of the Lewisohn case has been weakened by the holding of the Supreme Court in *Davis v. Las Ovas Co., Inc.*, supra, where it appeared that there had not been a full disclosure to all the existing stockholders at the time of the sale, and recovery was allowed although it would inure in part to guilty stockholders. "The case has removed the *ratio decidendi* of the Lewisohn decision and may be regarded in the future as overruling

it." See Ehrich, Promoters, sec. 140.

⁶¹ *Davis v. Las Ovas Co.*, 227 U. S. 80, 86-87, 57 L. Ed. 426, 33 Sup. Ct. 197; *Yeiser v. United States Board & Paper Co.*, 107 Fed. 340, 52 L. R. A. 724; *Nebraska Mausoleum Co. v. Matters*, 108 Neb. 618, 627, 188 N. W. 231; *Frame v. Mahoney*, 21 Ariz. 282, 187 Pac. 584; *Jarvis v. Great Bend Oil Co.*, 66 Okla. 179, 183, 168 Pac. 450 (but in this case there were misrepresentations by the promoters); *Hughes v. Cadena De Cobre Min. Co.*, 13 Ariz. 52, 61 et seq., 108 Pac. 231; *South Jcplln Land Co. v. Case*, 104 Mo. 572, 580 et seq., 16 S. W. 390 (in this case,

poration, it is said, results from the fact that its members have been injured. They have been deceived in their corporate capacity. A single deceived stockholder, although he may have sold his stock subsequent to the transaction, is sufficient to give the corporation a right of action.⁶² By a straining of the principle, it has been applied to a situation where deceived parties have subscribed or agreed to purchase stock from the new corporation, but where the promoter has restricted the issue of stock to himself and his agents until after the transaction.⁶³ While all the actual stockholders were aware of the nature of the transaction, yet the deceived subscribers are regarded as the real parties in interest. At the time of the transaction, it is said, they were equitable stockholders; and to the extent that they were injured, "it was an injury to the corporation as representing their collective or corporate interests."⁶⁴

Effect of fraudulent scheme against future stockholders.—Suppose, however, that the promoter and his agents are the sole stockholders until after the transaction; and then, as part of the scheme, persons without knowledge of the promoter's profits are induced to subscribe for part of the original capital stock, and to pay to the corporation the funds which are the source of the promoter's profits. Does it follow that no wrong has been done to the corporation? It has been held by the United States Supreme Court,⁶⁵ which has been followed by some state courts,⁶⁶ including Minne-

also, there were misrepresentations of fact).

⁶² *Hughes v. Cadena De Cobre Min. Co.*, 13 Ariz. 52, 64-65, 108 Pac. 231. The fact that a recovery will inure to the benefit of the guilty members as well is not material. *Davis v. Las Ovas Co.*, 227 U. S. 80, 87, 57 L. Ed. 426, 33 Sup. Ct. 197; *Exter v. Sawyer*, 146 Mo. 302, 325, 47 S. W. 951.

⁶³ *Tilden v. Barber*, 268 Fed. 587, 600 et seq.; *American Barley Co. v. McCourties*, 150 Minn. 460, 463, 185 N. W. 506; *Arnold v. Searing*, 78 N. J. Eq. 146, 158-59, 78 Atl. 762; *California-Calaveras Min. Co. v. Walls*, 170 Cal. 285, 300 et seq., 149 Pac. 595; *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 203 Mass. 159, 199, 89 N. E. 193, 40 L. R. A. (N. S.) 314; *Pittsburg Min. Co. v. Spooner*, 74 Wis. 307, 320 et

seq., 42 N. W. 259, 17 Am. St. Rep. 149.

Where there are existing stockholders not connected with the promoter's scheme, all of whom know of the profit and no objection is made, the corporation has no cause of action. *Advance Realty Co. v. Nichols*, 126 Minn. 267, 148 N. W. 65.

⁶⁴ *California-Calaveras Min. Co. v. Walls*, 170 Cal. 285, 301, 149 Pac. 595. See also, *Arnold v. Searing*, 78 N. J. Eq. 146, 159, 78 Atl. 762.

⁶⁵ *Old Dominion Copper Mining & Smelting Co. v. Lewisohn*, 210 U. S. 206, 212 et seq., 52 L. Ed. 1025, 28 Sup. Ct. 634. See *Ball v. Breed*, *Elliott & Harrison*, 294 Fed. 227, 232. In this latter case the complaining stockholders were transferees of the promoters.

⁶⁶ *Metcalfe v. Mental Science Industrial Ass'n*, 127 Wash. 50, 220

sota,⁶⁷ that no right of action arises in favor of the corporation. The argument is that the only existing stockholders, the promoter and his associates, assented to the profit with full knowledge of the facts.⁶⁸ Consequently, at the time of the transaction no wrong was done to anyone, and the rights of the corporation are not changed by the fact that innocent members are subsequently induced to come in. The wrong, if any, is to the individual subscribers for fraud in the sale of stock to them.⁶⁹ The result is a multiplicity of suits. The small stockholder is barred, by the expenses of litigation, from asserting his right. The Massachusetts court⁷⁰ and a majority of other courts,⁷¹ considering these diffi-

Pac. 1, 4. See *Lilylands Canal & Reservoir Co. v. Wood*, 56 Colo. 130, 138 et seq., 136 Pac. 1026; *Continental Securities Co. v. Belmont*, 168 N. Y. App. Div. 483, 154 N. Y. Supp. 54, 59; *Hughes v. Cadena De Cobre Min. Co.*, 13 Ariz. 52, 65, 108 Pac. 231.

⁶⁷ See *Hoffman Motor Truck Co. v. Erickson*, 124 Minn. 279, 283-84, 144 N. W. 952. The court adopts the rule, but states that in this case it was not shown that subsequent stockholders were without knowledge of the facts when they purchased their stock. The case of *American Barley Co. v. McCourtie*, 150 Minn. 460, 185 N. W. 506, was apparently regarded by the writer in 35 Harv. Law Rev. 765, as taking a contrary position. But the case is distinguishable because there were innocent parties interested in the new corporation at the time of the transaction. See footnote 63.

⁶⁸ *Old Dominion Copper Mining & Smelting Co. v. Lewisohn*, 210 U. S. 206, 212 et seq., 52 L. Ed. 1025, 28 Sup. Ct. 634.

In re *Ambrose Lake Tin, etc., M. Co.*, 14 Ch. Div. 390, held, that although the scheme by which the mine was estimated much beyond its true value and shares issued in payment may have been intended to deceive the public, there was no fraud upon the company, all the members of which at the time were parties to the arrangement. See comment by Little, 5 Illinois Law Review 98, as to distinction from the Erlanger case.

⁶⁹ Rescission of the stock subscription was granted to the subsequent subscriber in *Hinkley v. Sac*

Oil & Pipe Line Co., 132 Iowa 396, 402 et seq., 107 N. W. 629, 119 Am. St. Rep. 654. In *Mason v. Carrothers*, 105 Me. 392, 407-08, 74 Atl. 1030, relief was granted by canceling the stock received by the promoters.

⁷⁰ *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 188 Mass. 315, 327-28, 74 N. E. 653, 108 Am. St. Rep. 479; s. c., 203 Mass. 159, 179, 89 N. E. 193, 40 L. R. A. (N. S.) 314. The same set of facts was presented in the *Lewisohn* case (footnote 65). For the history of this interesting litigation, see *Ehrich, Promoters*, sec. 128, p. 255 et seq. *Hayward v. Leeson*, 176 Mass. 310, 319, 320, 57 N. E. 656, 49 L. R. A. 725.

⁷¹ *Wills v. Nehalem Coal Co.*, 52 Ore. 70, 82-86, 96 Pac. 528; *Bennett v. Havelock*, 21 Ont. L. Rep. 120, 16 O. W. R. 19, 18 Ann. Cas. 354. See *Pietsch v. Milbrath*, 123 Wis. 647, 656, 658, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017 (recovery was denied because the statute of limitations had run; but in *Pietsch v. Krause*, 116 Wis. 344, 93 N. W. 9, the complaint in this same case was held good on demurrer); *Meier v. Eaton*, 46 S. D. 286, 192 N. W. 721, 722; *American Forging & Socket Co. v. Wiley*, 206 Mich. 664, 672, 173 N. W. 515; *Mason v. Carrothers*, 105 Me. 392, 404 et seq., 74 Atl. 1030; *Beal v. Smith*, 46 Cal. App. 271, 278, 189 Pac. 341, citing dictum in *California-Calaveras Min. Co. v. Walls*, 170 Cal. 285, 298, 149 Pac. 595. See also, 13 California Law Rev. 240; 8 Minnesota Law Rev. 520.

culties, have recognized a cause of action in the corporation in such cases.

The famous case of *Old Dominion Copper Mining & Smelting Co. v. Lewisohn*,⁷² was a bill in equity by the corporation to rescind a sale of mining rights, or in the alternative, to recover damages for the sale from one of the promoters. The promoters had paid \$1,000,000 for certain properties. They turned them over to the corporation in 1895 for 13/15 of the stock, having a par value of \$25 a share and a market value of \$3,250,000. The property was actually worth in the market not more than \$2,000,000. The difference between the market value of the stock which the promoters obtained and the market value of the properties turned over was approximately \$1,200,000. This profit was divided between the two promoters, Bigelow and Lewisohn. It was part of the scheme to sell twenty thousand (20,000) shares having a par value of \$500,000 by subscription to the public without disclosing the profit which they had taken for themselves.

The question presented was whether there was a corporate right of action. Is there a wrong done to the corporation when a large part of the authorized stock is issued to promoters in exchange for property at a big profit, and when all concerned in the corporation at the time consented to and ratified the transaction, but there was a fraudulent intention or scheme to sell shares to future subscribers without revealing the transaction? It was held sustaining a demurrer that no wrong had been done to the corporation. The corporation assented to the transaction with full knowledge of the facts by all those concerned in it.

The argument of Justice Holmes is based on the contentions that no right of action arises in favor of the corporation, because no wrong was done to it at the time of the issue of the stock for the mining property; that the corporation does not change its identity or rights when innocent new subscribers come in, and that the gist of the wrong was a fraud on the subsequent subscribers who were induced to pay or subscribe at par (\$25) for stock worth only about \$9.37 per share. Further, as a practical argument, if the corporation is allowed to recover the guilty as well as the innocent would get the benefit. At most 2/15 of the shareholders would be using the name of the corporation to recover secret profits which would enure also to 13/15 of the stockholders who were without claim. It was not shown that the orig-

⁷² *Supra*, note 65.

inal subscribers who were defrauded still owned stock when suit by the company was begun.

If the finding of a corporate injury is dependent upon an injury to persons who were innocent members at the time of the transaction between the promoter and the corporation, the position of the Supreme Court is logically correct.⁷³ But may there not be a distinct injury to the corporation although all of its members at the time of the transaction derive a benefit from it? When a corporation is launched, it embarks upon some business enterprise in which it aims to succeed. Success in that enterprise will depend in a large measure upon the honest judgment of those in control, unfettered by adverse interests and exercised with a view to the advancement of the corporate interests and the preservation of its assets. Consequently, when a promoter temporarily in control uses the corporation for his own private gain so that the corporate enterprise is deprived of the means on which its success depends, is there not a direct injury to the corporation?⁷⁴ Of course where future stockholders are not contemplated, no injury to the corporation can be found.⁷⁵ The interests of the corporation have become identical with those of the stockholders, and any action for the benefit of all the stockholders is for the benefit of the corporation. But where future members are contemplated, the corporation should be permitted to assert its right as soon as the new members come in, irrespective of whether they are original subscribers or merely transferees of promoters.

The leading authority in opposition to the view advanced by Justice Holmes in the U. S. Supreme Court is the opinion of Rugg, J., in *Old Dominion Copper Mining & Smelting Co. v. Bigelow*.⁷⁶

⁷³ What is the injury to the corporate entity if all consent except one or two innocent stockholders of a few shares? An injury to the corporation would seem to involve damage to their collective interests in the corporate funds or enterprise. The inadequacy of this theory to explain a corporate injury becomes apparent when it is considered that an innocent holder of a single share of stock is sufficient to give the corporation a cause of action.

⁷⁴ See *Pietsch v. Milbrath*, 123 Wis. 647, 656, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 945, 107 Am. St. Rep. 1017.

"The interests of the corporation, as a legal and economic entity, are not at all necessarily the same as the interests of stockholders, because the corporation has a persistent existence in a definite business while the identity of the stockholders is in a constant state of change." F. D. Bond, *Barrons*, p. 8, Aug. 9, 1926.

⁷⁵ In re *British Seamless Paper Box Co.*, [1881] L. R. 17 Ch. Div. 467, 474, 476 et seq. See *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 203 Mass. 159, 190, 89 N. E. 193, 40 L. R. A. (N. S.) 314.

⁷⁶ *Supra*, note 70.

Suit was begun against Bigelow in Massachusetts and against Lewisohn in the federal court in New York. The results were different. In Massachusetts Bigelow as one of two joint wrongdoers was held liable to the corporation for the entire profit which with interest amounted to over \$2,000,000. Rugg, J., says in *Old Dominion Mining & Smelting Co. v. Bigelow*: "This organization was conducted and controlled wholly by the defendant (Bigelow) and Lewisohn, through themselves and their agents. Without providing plaintiff corporation with an independent board of officers or representatives, they, as the responsible and only managers of the plaintiff, acting in its name, contracted with themselves as mine owners to sell to it the real estate of the Baltimore company, for \$2,500,000 of the capital stock of the plaintiff, and the outside properties, of trifling value at best, for \$750,000 of such capital stock, and to sell to the general public for working capital the remaining \$500,000 of capital stock of the plaintiff at par, without disclosing that they had sold property costing them only \$1,000,000 for three and a quarter times its cost" (i. e., in stock). By reason of their failure to disclose the real facts, they made out of their sale to the plaintiff corporation a secret profit of 50,000 shares. It was held, contrary to the federal ruling, that the promoter was liable to the corporation as well as to the defrauded subscribers individually, where such fraud on future subscribers was contemplated as an essential part of the scheme of promotion, though assented to by all existing stockholders. The contention of Rugg, J., in the Massachusetts case on principle is that the fiduciary relation of the promoter must continue until the corporation is completely established, and if the promotion scheme includes the conveyance of property and the procurement of working capital from the public, the obligation of faithfulness is coextensive with the plan. The promoter cannot as stockholder or director absolve himself from future liability to the corporation in his capacity as promoter. The corporation assent was not valid, because it did not assent when it could act independently. The assent was like that of a minor under guardianship.

The corporation as subsequently composed in part at least of shareholders who knew nothing of the promoters' scheme, and never assented to it, can sue for secret profits, and such a right of action will pass to a receiver. Promoters or directors cannot be heard to say that all the officers and shareholders at the time assented, where this was an illusory and fraudulent assent. They

owe a duty to the future subscribers who are to form the real company and furnish the real capital not to lay a trap by which their enterprise is made a source of secret and dishonest profit.⁷⁷

Subscribers have a right to suppose that the promoters have taken only so much stock as represents the fair market value of any properties which they have sold to the corporation.⁷⁸ If the promoters charge the corporation an excessive price, the corporation acting under their control owes a fiduciary duty not to invite the public to take stock at par without full disclosure. Some adequate remedy must be provided so that the organization of corporations may not be used as an instrument of fraud to deceive the public. It might well be made the law that the corporation is never finally bound by a transaction with its organizers operating unfairly to future stockholders until innocent stockholders with full knowledge of the facts have ratified the transactions between the organizers and the company.

The Massachusetts doctrine has been severely criticised by Mr. R. D. Weston ⁷⁹ on the following grounds: (1) If the promoters had

⁷⁷ *In re Leeds and Hanley Theatres, Ltd.*, [1902] L. R. C. D. 809. Promoters purchased music halls and sold them to a company at an inflated price. They disclosed their interest as vendors to the directors who were their nominees. The prospectus, for which they were responsible, did not disclose the fact that the promoters were the real vendors of the property to the company. The company afterwards went into liquidation. The promoters were held liable to pay to the company the amount of the secret profit so made by fraudulent overvaluation. They were under a fiduciary obligation not to defraud future allottees of shares who were invited to become shareholders in the company as well as the actually existent shareholders. *Society of Practical Knowledge v. Abbott*, [1840] 2 Beav. 559, 48 Eng. Rep. 1298. Promoters were the only ones interested at the time of the issue, but they contemplated selling stock directly after its issue; recovery was allowed. Compare *In re Ambrose Lake Tin, etc., M. Co.*, [1880] L. R. 14 Ch. D. 390 (recovery denied); *In re Darby*, [1911] 1 K. B. 95, 103.

⁷⁸ As Morawetz thus expresses the principle of equality (Corporations,

sec. 286): "Every shareholder in a corporation is entitled to insist that every other shareholder shall contribute his ratable part of the company's capital for the common benefit. . . . It would be a plain violation of the equitable rights of those shareholders who have contributed the amount of their shares in full to allow any person to have the benefits of membership without adding the amount of their shares to the company's capital." A similar wrong may be done to subsequent subscribers if directors and organizers wrongfully issue shares to prior members without full payment. See Berle, 39 *Harvard Law Rev.* 673 (nonvoting stock): "The management may not without full disclosure permit a corporate situation in which one or more classes of stock appropriate to their benefit any portion of the capital contribution of any other class or classes of stock." See 25 *Columbia* 43, 56: Any overvaluation by promoters results in their acquiring the benefit of contributions of future subscribers without an equivalent.

⁷⁹ R. D. Weston, *Promoters Liability*; *Old Dominion v. Bigelow*, 30 *Harvard Law Rev.* 39.

taken all the stock and subsequently sold it themselves, they would have escaped liability to the corporation. (2) Many persons whom Bigelow had not wronged profited at his expense. (3) The innocent subscribers are the only persons really injured by the wrongdoing of the promoters and they may no longer be stockholders. (4) Only 2/15 of the recovery could possibly reach the defrauded subscribers. (5) The doctrine takes away from the defrauded subscribers the remedy which belongs to them personally and gives it to the corporation. A theory upon which these criticisms and difficulties may be met is indicated by Mr. Weston himself and will be set forth below.

No corporate right of action where promoters take entire issue.—In cases where the only subsequent stockholders are transferees of the promoters, or of stockholders who assented to the transaction with full knowledge of the promoters' secret profits, the courts quite uniformly have taken the position that no cause of action exists in favor of the corporation because all of its original subscribers have assented to the transaction.⁸⁰ A recent federal case⁸¹ upholds this position, which of course is consistent with the United States rule. This position, however, seems on true principle inconsistent with the Massachusetts theory, for if a wrong

⁸⁰ Attorney General for Canada v. Standard Trust Co. of N. Y., [1911] A. C. 498, where every one interested in the capital of the company has with full knowledge concurred in the transaction attacked, the promoters may prove in the insolvency of the company even though the price charged the company was excessive. In re Ambrose Tin, etc., M. Co., [1880] L. R. 14 Ch. Div. 390, suit to make T. & M. account for difference between nominal value of their shares, and the property which they gave for them, an interest in a mine. It was held that although the scheme by which the mine was estimated at much beyond its true value might have been intended to deceive the public, there was no fraud on the company, as all the members were parties to the arrangement. There was no fraud on future allottees because the whole capital stock was given for the property purchased. The company had no remedy, and each purchaser, if deceived, must sue his vendor. Par-

sons v. Hayes, 14 Abb. N. C. (N. Y.) 419; Henderson v. Plymouth Oil Co., — Del. Ch. —, 131 Atl. 165, 171; Strattons Independence, Ltd. v. Dines, 135 Fed. 449; Inland Nursery & Floral Co. v. Rice, 57 Wash. 67, 106 Pac. 499. Cf. Society of Practical Knowledge v. Abbott, [1840] 2 Beav. 559, 48 Eng. R. 1298; Mile Wide Copper Co. v. Piper, — Ariz. —, 239 Pac. 799, 43 A. L. R. 1359, 1363n (duty of promoter to account for proceeds of stock issued to him); Hamilton v. Hamilton Mammoth Mines, 110 Ore. 546, 223 Pac. 926; Blum v. Whitney, 185 N. Y. 232, 77 N. E. 1159, 1161 et seq.; Tompkins v. Sperry, Jones & Co., 96 Md. 560, 580 et seq., 54 Atl. 254; Foster v. Seymour, 23 Fed. 65. See St. Louis, Ft. S. & W. R. Co. v. Tiernan, 37 Kan. 606, 633 et seq., 15 Pac. 544; Lilylands Canal & Reservoir Co. v. Wood, 56 Colo. 130, 138 et seq., 136 Pac. 1026 (but the court treated the transferees as original subscribers).

⁸¹ Ball v. Breed, Elliott & Harrison, 294 Fed. 227, 231 et seq.

to the corporation at the time of the transaction is found where subsequent stockholders by subscription are contemplated, it is hard to see any substantial basis for distinction where the intended stockholders are transferees of the promoter.⁸²

As Ehrich says "if it is a fraud for promoters to make a profit out of the promotion without a disclosure to the directors or stockholders, it can make but little difference whether such profit is taken immediately before or immediately after the subscriptions are obtained, or whether the subsequent shareholders are brought in as original subscribers or as purchasers from the promoters."⁸³ The doctrine that there is no corporate right of action if the promoters themselves take the entire capital stock for property sold at an exaggerated price, despite the fraudulent intention of reselling the stock at once to the public, is due to the mistaken idea that it is necessary to find a fraud on the corporate entity rather than on the stockholders. The corporation ought to be able to hold the promoter to account for secret profits for the benefit of any persons defrauded in the promotion process.

Corporate right of action and sales of treasury stock.—Another situation is where the promoters return to the corporation so-called treasury stock to be sold for the benefit of the company, from the shares issued to them in payment of property. Are the purchasers of such shares to be considered as taking indirectly from the promoters, or as original subscribers? Does such a transaction give rise to a corporate right of action for promoters' profits concealed from subsequent subscribers or purchasers contemplated as part of the promotion? It has been held in some cases that the sale of treasury stock under such circumstances will give a corporate right of action for secret profits to the same extent as though the shares had been sold by original subscription.⁸⁴

⁸² See Ehrich, Promoters (1st Ed.), sec. 121, p. 237, and sec. 130, p. 265. The inconsistencies of the position taken by the Massachusetts court are pointed out in a criticism of the Bigelow case, Weston, Promoter's Liability, 30 Harv. Law Rev. 39, 44, 55 et seq. The contention of the writer is that the injury is to the subsequent subscribers and not to the corporation.

⁸³ Ehrich, Promoters, secs. 120, 121, 130.

The liability of the promoter should not depend upon the form

of the transaction, the device or subterfuge employed, rather than the substance of the transaction.

⁸⁴ California-Calaveras Min. Co. v. Walls, 170 Cal. 285, 149 Pac. 595: "The court will look beyond the form which the transaction took to its substance, and the obvious intent of the parties in the entire matter for the purpose of preserving and securing the rights of the real parties in interest and to circumvent fraud." See also, Mason v. Carrothers, 105 Me. 392, 74 Atl. 1030.

The situation may be regarded as different than where the shares are actually taken by the promoters and sold by them to the public, even though the promoters falsely represent the shares sold by them to be treasury stock. The cause of action then is personal. In a recent New Jersey case⁸⁵ the three promoters at the first meeting agreed that the corporation should purchase of them a license in consideration of the issue to themselves of all the common stock of no par value. Each share was then worth about 6 $\frac{2}{3}$ cents. A campaign for the sale of stock was instituted by the corporation and subscription blanks were used which would lead to the belief that the company itself was selling the stock, which was sold at around \$10 per share, and \$50,000 was divided by the promoters instead of being paid to the corporation as capital. By selling his own stock as treasury stock the promoter represented to purchasers that their purchase money would go into the corporate treasury. Thus the corporation did not realize from its non-par stock what it could have realized and the corporation was defrauded as well as the purchasers. It was a mere device to cheat all parties concerned. But it was held that the promoters were not liable to the corporation although if the stock had had a par value, it was said a different question would arise. Why this would make any difference does not appear.

In *Mason v. Carrothers*,⁸⁶ the promoters of a corporation succeeded in transferring to the corporation for \$100,000 of its preferred stock and \$799,400 of its common stock, certain patent

⁸⁵ *Piggly Wiggly, Del., Inc. v. Bartlett* (N. J. Ch.), 129 Atl. 413, 418. See 26 Columbia Law Rev. 447, 452. A promoter obtained 15,000 shares of common stock of no-par value in exchange for property which cost him \$1,000. He then sold this to the public realizing some \$50,000, which proceeds he retained. Can the corporation recover if the subscribers were led to suppose that their subscriptions would go into the treasury assets? Held, no, although the common stock was sold for an average of \$10 per share, which had been taken by the promoters at about 6 or 7 cents per share.

⁸⁶ 105 Me. 392, 401, 74 Atl. 1030, 1037. See 5 Ill. Law Rev. 87, 102. Promoters turned over to the corporation patent rights for which they were paying but one-tenth of

the consideration in stock received, which was carefully concealed from the purchasing public. Subsequent *bona fide* purchasers of stock from the treasury without notice of the profit obtained by the promoters may sue in equity for a cancellation of the stock so obtained. The bill was brought by the persons actually defrauded, the subsequent *bona fide* purchasers. This was a representative suit which presupposes a right of action in the corporation, and the suit was brought in behalf of all holders of preferred stock. See *Ehrich on Promoters*, sec. 129. The object of the bill was restitution of the stock itself which the promoters secured from the corporation in violation of their fiduciary duty while the corporation was manned by the promoters.

rights which the owners of such rights were ready to transfer to the corporation for \$100,000 of its preferred stock and \$50,000 of its common stock. The owners of the patents did transfer such rights to the corporation for the less consideration, but the promoters took care that the transfer should be made not directly to the corporation but through themselves as a conduit and that \$749,400 of the common stock should adhere to them in transit. It was held that subsequent purchasers of the preferred stock from the treasury paying full cash value therefor and without knowledge of the transaction on the part of the promoters could maintain a representative suit in equity for the cancellation of the shares so obtained. The defendants relied upon a line of cases holding that if such a transaction is agreed to by all the stockholders existing at the time, even though they be dummy stockholders, no fraud is committed upon the corporation and the corporation itself cannot rescind. The court said that since the action was brought in the names of the parties defrauded, and sought relief which inured directly in their behalf, it did not seem necessary to choose between the views of the Massachusetts and United States Supreme Courts, as it would have been if the suit were brought in the name of the corporation. But the case is really a clear authority in favor of the Massachusetts view, as it was a representative suit.

Duty of promoter as to subsequent issue of stock.—There is on principle a question as to the duty of promoters to disclose a transaction by which a large amount of stock was issued for a patent or other assets of doubtful value to subsequent subscribers when the promoters at the time constituted the whole company and there was no design to impose on other people who should come in afterwards. Most authorities hold that this is different from a case where a fraud was intended on future subscribers from the start. In *Re British Seamless Paper Box Co.*⁸⁷ the official liquidator in winding up proceedings sought to charge the directors with misfeasance and breach of trust in obtaining bonus shares and in carrying out an agreement with the promoters. Three promoters owning an untried patent organized a company to manufacture paper boxes and by agreement of January 7, 1874 as-

⁸⁷ L. R. 17 Ch. Div. 467. See Little, Promoters' Frauds, 5 Ill. Law Rev. 87, 95, 100. The test of the validity of the transaction of the promoters should not be the pres-

ent purpose but the natural effect of their conduct to deceive and defraud subsequent subscribers. Ehrlich, Promoters, 124, 125.

signed the patent for £30,000 out of a total capital of £50,000 in shares. At the time of the formation of the company it consisted of eight men and was not intended to consist of any more. Every member at the time was fully aware of and confirmed the transaction of purchase from the promoters. About a year or so later the company needed more capital and stock was sold to five strangers who had no knowledge of the transaction with the promoters. They now complain that the directors issued an excessive amount of shares to the promoters without adequate consideration. It was held that no fraud had been committed on the company. The official liquidator could not call on the directors to account for abuse of authority or neglect of duty. The subsequent issue of shares not being part of the scheme originally contemplated did not give the company any right to complain of what had been assented to by all the existing stockholders. But there was a dictum that if there had been an intention to cheat future shareholders, the promoters would be liable for profits so obtained. Here the transaction was perfectly honest at the time.

The question has been raised, however, whether an arrangement ratified by every shareholder, the purpose of which is honest, may not be as grievous a wrong and fraud to purchasers of new issues of stock as the same act if performed with the deliberate purpose of defrauding subsequent subscribers.⁸⁸ An arrangement which produces an unjust inequality in the issue of shares without the knowledge or acquiescence of the subsequent shareholders affected gives the old an unfair advantage over the new. It is putting the corporation in such a position that those who come in later at par are induced to give a present to those who got in on the ground floor, and the effect of concealment is a wrong or trap even if not so intended.

Theory of representative right to sue in corporation.—Neither the United States Supreme Court nor the Massachusetts theory satisfactorily covers all the situations or the different devices by which the crafty promoter may gain a secret profit by nondisclosure and manipulating the corporate organization. If it is the duty of the corporation to protect its subscribers against any dishonest or fraudulent action of its promoters and officers this would seem to be a sufficient ground to support a corporate right

⁸⁸ Little, *Promoters' Frauds*, 5
Illinois Law Rev. 87, 99.

of action against the promoter in every case in which he realizes a profit fraudulently at the expense of subscribers or purchasers of treasury stock, or wherever the promoter is dishonestly diverting funds or securities which affect the success of the enterprise or the just relations of the stockholders as such. If the parties who are defrauded represent only a minority of the corporation there is no reason why the decree may not be so moulded that redress will accrue only to those persons who were wronged, and not to the corporation as a whole, including those who participated in the guilt.⁸⁹

It seems to be true in these cases, as Mr. Weston says,⁹⁰ that the gist of the action against the promoter is not a breach of duty to the corporation, but is a breach of duty which the promoter owes to future subscribers. It may be true that the Massachusetts doctrine (generally followed) can be supported only so far as the subscribers who are the persons directly injured are protected by an action in the corporate name to undo the fraud by the mechanism which the promoter has used as an instrument of fraud. The injury where there are innocent stockholders kept in ignorance of the secret profit is in reality to the individual stockholders no matter how large or small their number, and not to the corporation as an entity. Practical considerations, however, strongly favor recognizing a corporate right of action in view of the impracticability of numerous individual suits, and the prohibitive cost of litigation to the small stockholder. This theory does not take away from the subscribers the remedy which belongs to them personally, but merely gives through the corporation an alternative and more adequate remedy. The recognition of the theory that the corporation sues as a trustee or representative to redress wrongs done by the promoter to the defrauded subscribers will make it possible to avoid holding the promoter as in the Bigelow case for an amount out of all proportion to the damages sustained by the subscribers, "without knowing whether a single person

⁸⁹ *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 Atl. 645, 650-652: "The corporation is in the nature of a trustee suing for its *cestui que trust*. . . . Some of the cases seem to go so far as to hold that where there is one innocent stockholder, in a suit in the name of the corporation the whole amount found due must be recovered on the

principle apparently that, 'a little leaven leaveneth the whole lump,' but we cannot apply that doctrine to a case such as this." There could be no recovery for the benefit of any of the shareholders who acquiesced. See *Brown v. De Young*, 167 Ill. 549, 47 N. E. 863.

⁹⁰ *Op. Cit.* 30 *Harvard Law Rev.* 39, 60; 25 *Mich. Law Rev.* 832.

whom they believe he had cheated would be made whole, and without perceiving that less than 1/7 of that amount would have sufficed to atone for all the wrongs of which he had been guilty. . . . As the promoter has used the corporation as a means of deceiving the public, so the court, by invoking the fiduciary theory, may use the corporation as a means of righting the wrong. . . . It is obvious that in a proper case a single suit brought by the corporation may redress the wrongs suffered by all the subscribers, many of whom, if left to pursue their separate remedies, would probably not secure any redress at all."⁹¹ The defrauded subscribers are the real victims, but to avoid the practical difficulties of innumerable suits by individual stockholders, and the resulting injustice to small stockholders, for whom the expense of litigation is often times prohibitive, the promoter under all circumstances should be held accountable to the corporation for secret profits. Even if the whole body of stockholders are not victims, those defrauded may seek redress either by individual suits or through the corporation, which like a trustee, owes the duty to undo the wrong to which it was made a party or at least the instrumentality.

§ 51. Remedies of corporation and of stockholders for fraud of promoters.

When a promoter of a corporation fraudulently makes a secret profit in transactions on behalf of or with the corporation, there are several remedies against him. In the first place, the corporation may restore, or offer to restore, what it has received, and sue to set the transaction aside and recover what it has parted

⁹¹ Weston, *op. cit.* 30 Harvard Law Rev. 39, 68. On stockholders as beneficiaries, *Hyde Park Terrace Co. v. Jackson Bros. Realty Co.*, 161 N. Y. App. Div. 699, 146 N. Y. Supp. 1037.

In *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N. W. 1024, 60 L. R. A. 927, 108 Am. St. Rep. 716, Pound, C., said: "The case of *Swift v. Smith* [65 Md. 428, 5 Atl. 534, 57 Am. Rep. 336] has been criticized, as we think with some reasons, so far as it deals with the sole stockholder as if he had some title to the property. But, so far as it sustains the proposition that, between the corporation and the stock-

holder, the latter is to be recognized as the real beneficiary, and consequently that equitable rights and remedies, the benefit whereof would inure solely to the shareholder, are to be regarded as exercised for him by the corporation, and not as something belonging to it independently, the decision is in accord with the authorities." See *Francis Oil & Refining Co. v. David A. Manville Co.*, 296 Fed. 349; *Richard Hanlon Millinery Co. v. Mississippi Val. Trust Co.*, 251 Mo. 553, 158 S. W. 359; *Ehrich on Promoters*, sec. 140. See also cases cited in connection with representative suits. Post § 195.

with.⁹² Or it may maintain a suit in equity to compel the promoter to account to it for the secret profits made by him,⁹³ or an action of assumpsit to recover the same,⁹⁴ or an action for damages,—as for the sum lost by being deprived of the power of issuing its shares to other persons where the promoter has unlawfully taken stock without consideration.⁹⁵ Or a suit to recover such profits may be maintained by a receiver of the corporation.⁹⁶ If the injury from the fraud of promoters of a corporation is to the corporate body, representing the stockholders collectively, and not to the stockholders individually, an action against the promoters to recover damages for the fraud, or to compel an accounting for secret profits, should be brought by the corporation, and not by the stockholders individually.⁹⁷ But a stockholder may bring a representative suit in equity if the corporation is in the control of the promoters, or if the officers fraudulently refuse to bring the suit.⁹⁸ Individual stockholders may maintain actions against a promoter of a corporation to recover for individual frauds as contrasted with frauds on the corporation.⁹⁹ And if the

⁹² *Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444; *Erlanger v. New Sombrero Phosphate Co.*, 3 App. Cas. 1213, aff'g 5 Ch. Div. 73; *Limited Inv. Ass'n v. Glendale Inv. Ass'n*, 99 Wis. 54, 74 N. W. 633; *Hebgen v. Koeffler*, 97 Wis. 313, 72 N. W. 745.

⁹³ *Tilden v. Barber*, 268 Fed. 587; *Chandler v. Bacon*, 30 Fed. 538; *Bagnall v. Carlton*, 6 Ch. Div. 371; *Emma Silver Min. Co. v. Grant*, 11 Ch. Div. 918; *Pittsburgh Min. Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149; *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78, 35 Atl. 436, aff'd 56 N. J. Eq. 411, 41 Atl. 1115, and modified 58 N. J. Eq. 556, 43 Atl. 671; *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159; *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *American Forging & Socket Co. v. Wiley*, 206 Mich. 664, 173 N. W. 515. See 18 L. R. A. (N. S.) 1122n.

⁹⁴ *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. St. 202, 100 Am. Dec. 628.

⁹⁵ See *Getty v. Devlin*, 54 N. Y. 403; s. c., 70 N. Y. 504; *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *In re Leeds & Han-*

ley Theatres, Ltd., [1902] 2 Ch. 809, 825; *Ehrich, Promoters*, sec. 165.

⁹⁶ *Chandler v. Bacon*, 30 Fed. 538. Compare *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725.

Jubilee Cotton Mills v. Lewis, [1924] A. C. 598. Promoter must account for a secret profit of £35,390 to the liquidator made on shares and debentures obtained without corresponding benefit to the company itself and without disclosure, even if the issue was invalid.

⁹⁷ *Hughes v. Cadena De Cobre Min. Co.*, 13 Ariz. 52, 108 Pac. 231; *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; *McAleer v. McMurray*, 6 Phila. (Pa.) 244; 8 Minnesota Law Rev. 520; 13 California Law Rev. 240.

⁹⁸ *Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444; *Exter v. Sawyer*, 146 Mo. 302, 47 S. W. 951; *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030.

⁹⁹ *Emery v. Parrott*, 107 Mass. 95; *Franev v. Warner*, 96 Wis. 222, 71 N. W. 81; *Brewster v. Hatch*, 10 Abb. N. C. (N. Y.) 400; s. c., 122 N. Y. 349, 25 N. E. 505, 19 Am. St. Rep. 498; *Getty v. Devlin*, 54 N. Y. 403;

promoter has been guilty of false and fraudulent representations in the prospectus or otherwise, any subscriber who has been thereby induced to invest in the enterprise may maintain an action of deceit to recover damages sustained by him.¹⁰⁰ A subscriber may rescind his subscription, and recover what he has paid thereon, if the corporation was a party to the fraud, but not otherwise.¹⁰¹

§ 52. Liability of promoters to subscribers on failure to organize corporation.

Promoters of a proposed corporation, who receive money from subscribers to its stock as a deposit or preliminary payment on their subscriptions, are liable to the latter to return the money, if they fail to organize the corporation, unless it appears that there was an understanding to the contrary; and it can make no difference that they have paid out the money for expenses preliminary to organization.¹⁰² There is no such liability, however, in the absence of fraud on the part of the promoters, if the money was paid with the understanding that it should be applied to expenses in procuring incorporation, and that the subscribers paying the same did so merely for the purpose of furthering the scheme.¹⁰³

s. c. 70 N. Y. 504. See 18 L. R. A. (N. S.) 1125n.

¹⁰⁰ Downey v. Finucane, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. (N. S.) 307 (action for damages by purchaser for deceit against promoter for fraud in selling bonds); Getty v. Devlin, 54 N. Y. 403, s. c., 70 N. Y. 504; Brewster v. Hatch, 10 Abb. N. C. (N. Y.) 400; s. c., 122 N. Y. 349, 25 N. E. 505, 19 Am. St. Rep. 498; Gebhard v. Bates, 2 El. & Bl. 476.

¹⁰¹ Franey v. Warner, 96 Wis. 222, 71 N. W. 81. Ante, § 44.

¹⁰² Greiger v. Salzer, 63 Colo. 167, 165 Pac. 240; Lang v. Blocki, 286 Ill. 91, 121 N. E. 163; Nockells v. Crosby, 3 Barn. & C. 814, 5 Dowl. & R. 751; Bradford v. Harris, 77 Md. 153, 26 Atl. 186; Manistee Lumber Co. v. Union Nat. Bank of Chicago, 143 Ill. 490, 32 N. E. 449; Hudson v. West, 189 Pa. St. 491, 42 Atl. 190. See 25 Michigan Law Rev. 670.

¹⁰³ Garwood v. Ede, 1 Exch. 264.

CHAPTER VI.

POWERS OF CORPORATIONS.

I. IN GENERAL.

§ 53. Objects and powers.—A corporation has such powers, and such powers only, as are expressly or impliedly conferred upon it by the objects specified in its charter, and any act which is not reasonably conducive to such objects is ultra vires however beneficial it may be to the corporation. Officers and agents have no actual authority to do acts on behalf of the corporation outside its purposes or objects.

Formerly corporations were usually created by special act of the legislature and the charter was a statute. It was then natural to regard the corporation as a legal person deriving its existence and its powers by a grant from the state. Today corporations are created by registration under general laws by agreement of the incorporators who associate themselves by articles which specify the business which they authorize the directors to carry on with the capital contributed. There is no formal grant of powers, but these are authorized according to what is incidental to effectuating the purposes or objects.¹ The statement of the objects or purposes or powers results in defining the scope of authorized corporate activity and limits the powers of the corporate officers and agents. These objects are often made so multifarious that it has been said that the aim seems to be "not to specify, not to disclose, but to bury beneath a mass of words the real object or objects of the company with the intent that every conceivable

¹ North American Life Assur. Co. v. Silvers', Ltd., 16 Alberta Law Rep. 435, 60 Dom. Law Rep. 22. The distinction between "objects" and "powers" is well recognized. Thus the issuing of promissory notes may be merely one of the powers of a

company in carrying out its objects. Such a power may be implied even if not expressly given. If expressly mentioned it would usually be a power and not an object or business of the company. See 32 Harvard Law Rev. 279n.

form of activity shall be found included somewhere within its terms."²

Primary objects.—It is a rule of construction, developed in the English cases, that where a number of different objects or purposes are stated those which appear to embody the main or dominant objects of the company are controlling, and all other clauses are to be treated as merely ancillary to the main object and as limited thereby. General concluding words, "to do all such other things as the company may think expedient," will not be construed to add anything to what the law already implies as incidental.^{2a} It is also a general rule that, when the charter of a corporation enumerates certain objects or purposes or lines of business, it is to be construed as excluding or withholding all powers other than those which are reasonably necessary to the proper accomplishment or prosecution of those objects. A manufacturing company, authorized by its charter to manufacture only, cannot lawfully engage in buying and selling goods, where such business is not necessary or incidental to its manufacturing business. Nor can it engage in any other business not reasonably incidental to its manufacturing.³

² For criticism of drawing incorporation paper with too wide objects and a provision that none is to be deemed subsidiary or auxiliary to the others, see *In re Anglo Cuban Oil, etc., Co., Ltd.*, L. R. [1917] 1 Ch. 477; *Cotman v. Brougham*, [1918] A. C. 514, 522. The statement of the objects has a double purpose, first that the intending subscriber who contemplates investment may know the field in which it is to be put at risk; second that one who enters into dealings with the company may know whether the contractual relation is within its corporate powers. Powers are not required to be specified as contrasted with objects or purposes.

^{2a} *Palmer, Company Law* (11th Ed.) 71, 72; *International Land Co. v. American Suburbs Co.*, 119 Minn. 77, 85, 137 N. W. 395. Action to enjoin the construction of a line of street railroad upon a street by a corporation created for the purpose of dealing in real estate. The general clause of its articles of association authorizing the "transaction of any lawful business" must be lim-

ited to such matters as have some relation to the general business of the company.

³ *Day v. Spiral Springs Buggy Co.*, 57 Mich. 146, 23 N. W. 628, 58 Am. Rep. 352; *People ex rel. Tiffany & Co. v. Campbell*, 144 N. Y. 166, 38 N. E. 990; *Chewacla Lime Works v. Dismukes*, 87 Ala. 344, 6 So. 122, 5 L. R. A. 100.

A corporation organized solely for the manufacture of electric appliances has no power to engage in the business of selling electric supplies manufactured by others. *Powell v. Murray*, 157 N. Y. 717, 53 N. E. 1130, aff'g 3 N. Y. App. Div. 273, 38 N. Y. S. 233.

Nicollet Nat. Bank v. Frisk-Turner Co., 71 Minn. 413, 74 N. W. 160, 70 Am. St. Rep. 334. A corporation whose business is described as the manufacturing of clothing of every description, and the sale of the clothing so manufactured, and the transaction of all other business necessary and incidental to such manufacture and sale of clothing," has no implied power to engage in the buying and selling of ready-made

A railroad or steamboat company has no power to engage in buying and selling goods,⁴ or to speculate in land.⁵ And a turnpike company has no power to purchase wagons and horses, and engage in transporting passengers for hire, even over its own road.⁶ The holding of a "world's peace jubilee and international musical festival" is an enterprise wholly outside the objects for which a railroad corporation is established; and a contract to pay, or to guarantee the payment, of the expenses of such an enterprise is neither a necessary nor an appropriate means of carrying on the business of the railroad corporation. Such a contract cannot be held to bind the corporation by reason of the supposed benefit which it may derive from an increase of travel over its road, in spite of the fact that the festival was held in reliance upon the agreement.⁷

Statutes or constitutions sometimes contain a wholly useless provision to the effect that no corporation shall possess or exercise any corporate powers not given by law, or engage in any business other than that authorized by its charter, or employ its funds for any other purpose than to accomplish the legitimate objects of its creation.⁸ It is difficult to ascertain what practical consequences the legislators intended to have flow from such general prohibitions.

§ 54. Powers impliedly conferred.

(1) A corporation has, by implication, certain inherent powers which are regarded as incidental to corporate existence. These are:

(a) The power or faculty of perpetual succession, or continuous existence during the period for which it is created.

clothing, a purely mercantile business. That is unauthorized by the articles.

⁴ *Attorney General v. Great Northern Ry. Co.*, 1 Drew & S. 154; *Northwestern Union Packet Co. v. Shaw*, 37 Wis. 655, 19 Am. Rep. 781.

⁵ *Case v. Kelly*, 133 U. S. 21, 33 L. Ed. 513, 10 Sup. Ct. 216; *Williams v. Johnson*, 208 Mass. 544, 95 N. E. 90. An arrangement by which land was conveyed by a railroad to trustees to develop and sell the property, which might be of long duration, was held to contemplate real estate business or speculation, which was beyond the power of a railroad corporation. The court de-

clared that the protection of the stockholders requires that the company be confined strictly to the business for which it was organized. Massachusetts laws do not permit corporations to hold real estate for the purpose of profit.

⁶ *Downing v. Mt. Washington Road Co.*, 40 N. H. 230.

⁷ *Davis v. Old Colony R. Co.*, 131 Mass. 258, 41 Am. Rep. 221 (a leading case).

⁸ *In re Gilchrist Co.*, 278 Fed. 235; *Jackson v. Western U. Tel. Co.*, 269 Fed. 598; *People v. Orange County Farmers' & Merchants' Ass'n*, 56 Cal. App. 205, 204 Pac. 873.

- (b) The power to sue and be sued, and to grant and receive, by its corporate name.
- (c) The power to take, hold, and convey land and chattels for purposes which are not foreign to the objects of its creation.
- (d) The power to have a corporate seal.
- (e) The power to make by-laws for its government.
- (2) In addition to these powers, a corporation has the implied power to make all contracts and do all acts which are reasonably necessary to enable it to accomplish objects for which it was created.

The mere creation of a corporation is sufficient to confer upon it all those powers which are regarded as incident to corporate existence.⁹ The powers which are thus impliedly conferred are: First, the power to have succession, so that the corporation will continue to exist as the same legal entity, notwithstanding the death or withdrawal of members; second, the power to sue and be sued, and to grant and receive, in the corporate name; third, the power to purchase, hold, and convey real and personal property for such purposes as are within the objects of its creation; fourth, the power to have a common seal; fifth, the power to make by-laws for its government. In addition, powers are also implied as incidental to the particular corporation, because they are necessary to enable it to properly exercise the powers which are expressly granted, and to accomplish the objects for which it is created. The general rule is that the charter of a corporation impliedly confers upon it the power to make all contracts and to do all acts which are reasonably necessary to enable it to accomplish the objects of its creation.¹⁰

As Palmer says:

“If a company is formed, for example, to buy, sell and deal in coal, *it may, for the purpose of carrying out its objects*, not only buy, sell and deal in coal, but may—(1) purchase or take on lease stores; (2) open shops and agencies; (3) buy and hire trucks, carts, horses; (4) employ labour; (5) draw and accept bills of

⁹ Sutton's Hospital Case, 10 Coke, 23a; Conservators of River Tone v. Ash, 10 Barn. & C. 349; Thomas v. Dakin, 22 Wend. (N. Y.) 9. See Morawetz, Corporations, sec. 325.

¹⁰ Simpson v. Directors of Westminster Palace Hotel Co., 8 H. L. Cas. 712; Richelieu Hotel Co. v. International Military Encampment

Co., 140 Ill. 248, 29 N. E. 1044, 33 Am. St. Rep. 234; People ex rel. Moloney v. Pullman's Palace Car Co., 175 Ill. 125, 51 N. E. 664, 64 L. R. A. 366. See 1 Illinois Law Bulletin, p. 42, Legislative policy in the interpretation of corporate powers. The purposes and consequent powers depend on the will of the in-

exchange; (6) borrow and give security; (7) incur debts; (8) make contracts for purchase or supply; (9) have banking account; (10) bring actions and take proceedings; (11) compromise actions and disputes (Bath's case, 8 Ch. D. 334); (12) employ agents; (13) pay bonuses and pensions to employees, for these things are fairly incidental to and consequential on the object to 'buy, sell, and deal in coal.' " 11

Necessity of amplifying objects clause.—"Wide as the powers thus vested are, experience has shown that they are not wide enough to cover many of the transactions which are found necessary or convenient in the course of a company's business, irrespective of the fact already alluded to, that an over-concise statement of objects leaves, in the opinion of business men, too much to implication of law, thereby necessitating constant resort to legal advice, and also hampering business by the doubts it induces amongst outsiders as to the company's capacity to engage in a given transaction.

"Hence the objects clause of by far the greater number of existing companies is expressed in considerable detail and specifies, in most cases at any rate, some objects which might be, to a lawyer, implied." 12

Such ancillary clauses which may be inserted to advantage are provisions authorizing the company to carry on various other businesses which it might possibly be desirable to carry on later, and thus give the company full freedom to expand its business; a clause empowering the company to enter into a joint venture or agreement for sharing profits or a partnership; a clause empowering the company to take shares in other companies; to promote other companies for purposes deemed beneficial to the company; to guarantee the performance of contracts by customers and others; a power to sell and dispose of the business and entire property of the company by majority vote, etc.

Relation between the act and the objects of the corporation.—In order that a corporation may have the implied power to make a particular contract or conveyance, the act must be directly and immediately appropriate to the execution of the specific objects

corporators and the skill of the draftsman. Powers are implied with great liberality.

11 Palmer's Company Law (11th Ed.), p. 64.

12 Ibid. p. 64.

specified in the charter, and not bear merely a slight or remote relation to them.¹³

As was said by a Missouri court,¹⁴ a corporation charter rarely specifies or enumerates particular contracts which a corporation may make, but it must specify the business which it may do, and of course its contracts must arise in the lawful pursuit of its business or be connected with it and intended for its advancement. The question is whether it pertains to the corporation's business or whether it is wholly foreign to the business for which it was chartered.

It is not necessary, however, that the act shall be usual under the circumstances. Nor need it be necessary in the sense of indispensable. All that is required is that it shall be reasonably appropriate and convenient.¹⁵ A corporation may exercise by its board of directors, or duly authorized officers or agents all such incidental powers as may be appropriate to carry on the business specified and accomplish the objects for which it is incorporated. The implied powers are wide enough to meet the needs of the business, and to conduct its affairs within the general scope of the lines of enterprise authorized.¹⁶ The test is a vague one, but in general the directors have discretion to authorize the doing of anything on behalf of the corporation which may be regarded as fairly incidental or auxiliary to the objects and purposes specified in the charter or articles of incorporation. No uniform rule can be laid down as to what is or is not incidental or auxiliary to the main business of a corporation or expedient in the protection, care and management of its property.¹⁷ Various illustrations may, however, be given.

A gas company may incidentally deal in such patented gas fixtures and appliances as will induce new customers to use gas, or

¹³ *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268, 283, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319; *Franklin Co. v. Lewiston Institute for Savings*, 68 Me. 45, 28 Am. Rep. 9; *People ex rel. Moloney v. Pullman's Palace Car Co.*, 175 Ill. 125, 51 N. E. 664, 64 L. R. A. 366.

¹⁴ *Orpheum Theatre & Realty Co. v. Seavey & Florsheim Brokerage Co.*, 197 Mo. App. 661, 199 N. W. 257.

¹⁵ *Madison, W. & M. Plankroad Co. v. Watertown & P. Plankroad*

Co., 5 Wis. 173; *Clark v. Farrington*, 11 Wis. 306; *Central Ohio Natural Gas & Fuel Co. v. Capital City Dairy Co.*, 60 Ohio St. 96, 53 N. E. 711, 64 L. R. A. 395.

¹⁶ The operation of a smelter to make castings from iron ore is within the power of an auto manufacturing corporation, where it is a means of manufacturing. *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N. W. 668, 3 A. L. R. 413.

¹⁷ *In re Gilchrist Co. (Claim of Wm. Filene's Sons Co.)*, 278 Fed. 235.

old customers to use more.¹⁸ A brewing company may lease, or lease and sublet, premises for the purpose of a saloon, in order to increase the sale of its beer.¹⁹

As a rule, a railroad company cannot engage in operating a line of boats beyond the terminus of its road, even though by doing so it may increase the business over its road.²⁰ But a railroad company may lawfully own boats for the purpose of transporting freight or passengers across navigable waters on its line, or across such waters at the end of its road and separating it from the substantial terminus.²¹ It has also been held that a railroad company may lawfully establish and maintain refreshment houses along its route for the accommodation of its passengers.²² The Supreme Court of the United States has held that a corporation operating a railroad in Florida could lease and maintain a hotel at the terminus of its road on a beach distant from any town, for the accommodation of passengers and employees.²³ To lease and maintain a summer hotel at the seaside terminus of a railroad might obviously increase the business of the company and the comfort of its passengers. A corporation organized for the purpose of mining only, cannot establish a railroad or steamboat line and engage in transporting the goods of others for hire; but it may lawfully make any necessary arrangements for the purpose of conveying its own coal or ore to the market or to a smelter, even though it may involve the opera-

¹⁸ *Malone v. Lancaster Gas Light & Fuel Co.*, 182 Pa. St. 309, 37 Atl. 932.

¹⁹ *Heims Brewing Co. v. Flannery*, 38 Ill. App. 95, 137 Ill. 309, 27 N. E. 286. But it has been held in *United States Brewing Co. v. Dolese & Shepard Co.*, 259 Ill. 274, 102 N. E. 753, 47 L. R. A. (N. S.) 898, that a corporation organized "to manufacture and sell all kinds of beer, ale and porter and to carry on a general brewer's business in all its branches," has no implied power to lease land and erect a boarding house and saloon, even though the sale of beer may be increased.

²⁰ *Pearce v. Madison & I. R. Co.*, 21 How. (U. S.) 441, 16 L. Ed. 184. And see *Colman v. Eastern Counties Ry. Co.*, 10 Beav. 1; *Central Railroad & Banking Co. v. Smith*, 76 Ala. 572, 52 Am. Rep. 353.

²¹ *Wheeler v. San Francisco & A. R. Co.*, 31 Cal. 46, 89 Am. Dec. 147. And see *Green Bay & M. R. Co. v. Union Steam-Boat Co.*, 107 U. S. 98, 27 L. Ed. 413, 2 Sup. Ct. 221. A railway company may be restrained from carrying on the omnibus business, where not reasonably incidental to the railway business as authorized by the charter. *Attorney General v. Mersey Ry. Co.*, [1907] A. C. 415.

²² *Flanagan v. Great Western Ry. Co.*, L. R. 7 Eq. 116; *Louisville Property Co. v. Commonwealth*, 146 Ky. 827, 143 S. W. 412, 32 L. R. A. (N. S.) 830.

²³ *Jacksonville, M. P. Ry. & Nav. Co. v. Hooper*, 160 U. S. 514, 40 L. Ed. 515, 16 Sup. Ct. 379; *Louisville Property Co. v. Commonwealth*, 146 Ky. 827, 143 S. W. 412, 32 L. R. A. (N. S.) 830.

tion of a railroad for the purpose, or the purchase and use of a steamboat.²⁴

If a corporation is authorized by its charter to buy, sell, and improve or develop land, it may lawfully adopt any means that may be necessary or proper in order to accomplish this purpose. Thus, it may build and maintain sawmills if the land is timber land;²⁵ or aid, by subscription or otherwise, in building a railroad.²⁶ It has been held, however, by the Texas court that a land company organized to develop a suburban tract had no implied power to join with a street railroad company in the issue of bonds on their joint credit and security, the proceeds to be divided between the two companies, even though the operation of a street railroad would greatly benefit the sale of the lands. It would seem, however, that the court might well have held that lending its credit for this purpose was within the discretion of the directors as auxiliary to its proper business.²⁷

If the business of a corporation is such as to render it necessary for it to own a certain kind of property, and at times such property is not necessary to its business, it may employ the same in a business or for a purpose which is not strictly within the objects of its creation, in order to prevent the same from remaining idle and unprofitable. Thus, a railroad company which owns steamboats for use in connection with its road may use them for excursions, instead of allowing them to lie idle, at times when they are not needed for their ordinary purposes.²⁸ A ferry company may, under similar circumstances, temporarily use its boats for other than ordinary purposes, or charter them to others, if they would otherwise remain idle.²⁹ And in like manner a hotel company or other corporation, whose buildings are larger than its present

²⁴ *Moss v. Averell*, 10 N. Y. 449; *Callaway Min. & Mfg. Co. v. Clark*, 32 Mo. 305.

²⁵ *In re Watts' Appeal*, 78 Pa. St. 370.

²⁶ *Louisville & N. R. Co. v. Literary Soc. of St. Rose*, 91 Ky. 395, 15 S. W. 1065.

²⁷ *Machen, Corporations*, sec. 87; *North Side Ry. Co. v. Worthington*, 88 Tex. 562, 30 S. W. 1055, 53 Am. St. Rep. 778. Compare *Richardson v. Bermuda Land & Live Stock Co.*, — Tex. Comm. App. —, 231 S. W. 337.

²⁸ *Forrest v. Manchester, S. & L. Ry. Co.*, 30 Beav. 40.

Where a corporation chartered for the manufacture of railway cars, in erecting its plant, constructed larger boilers than were then necessary, but such as would be necessary to supply its needs in the future, it was held that it was not *ultra vires* for it to sell and furnish its surplus steam power to another company. *People ex rel. Moloney v. Pullman's Palace Car Co.*, 175 Ill. 125, 51 N. E. 664, 64 L. R. A. 366.

²⁹ *Brown v. Winnisimmet Co.*, 11 Allen (Mass.) 326.

necessities require, may lease a portion until needed for its business.³⁰

Mr. Cook says of the relaxation of the line between *ultra vires* and *intra vires* acts done on behalf of a corporation:

"The courts are becoming more liberal, and many acts which fifty years ago would have been held to be *ultra vires* would now be held to be *intra vires*. The courts have gradually enlarged the implied powers of ordinary corporations, until now such corporations may do almost anything that an individual may do, provided the state and the stockholders and creditors do not object."³¹

This statement of Mr. Cook's seems to involve some confusion of thought between the question of whether or not an act is *intra vires* and what is the legal effect of an act *ultra vires*. If a contract or conveyance is within the implied powers of the corporation, neither the state nor the stockholders nor the creditors can possibly object to it on the ground of *ultra vires*. Even if it is *ultra vires* it is still a difficult question who will have any standing to object, and the objection will not in general be allowed to prevail for or against a corporation where it would defeat justice or work a legal wrong.³²

II. POWER TO TAKE AND HOLD PROPERTY.

§ 55. Restrictions express and implied.—In the absence of prohibitions in its charter or in the constitution or general law, a corporation has the power to take and hold real property whenever it is necessary or reasonably incidental to the business or objects authorized by its charter, but it cannot lawfully take and hold real property for a purpose which is foreign to the objects for which it was created.

Frequently, if not generally, the charter of a corporation confers upon it in express terms the power to acquire and hold real property, but an express grant of such power is not necessary. A

³⁰ Simpson v. Directors of Westminster Palace Hotel Co., 8 H. L. Cas. 712; People ex rel. Moloney v. Pullman's Palace Car Co., 175 Ill. 125, 51 N. E. 664, 64 L. R. A. 366.

³¹ Cook, Corporations (8th Ed.), sec. 681, quoted in Sales-Davis Co. v. Henderson-Boyd Lumber Co., 193 Ala. 166, 69 So. 527.

³² See infra, *ultra vires*, secs. 67, 71.

In Canfield & Wormser, Cases on Private Corporations (2nd Ed.), p. 259, certain citations in the note on implied powers show this same confusion between the question of what is *intra vires* and what is the effect of a contract being *ultra vires*, e. g., Bell v. Kirkland, 102 Minn. 213, 113 N. W. 271, 13 L. R. A. (N. S.) 793. This case has nothing to do with the question of implied powers.

manufacturing company may purchase land, not only for the purpose of erecting its factories, but also, if it is reasonably necessary, for the purpose of erecting dwellings for its employees.³³ It is said that, "a close and practical business relation subsisted between the provision made by the corporation for its employees and the object for which it was organized." But an Illinois case³⁴ held that a car manufacturing company could not lay out a town, with sewerage, water and light systems, and erect buildings for churches, dwellings, schools, and business houses for the benefit of its employees, since the enterprise was not necessary for the prosecution of its business, but the relation thereto was remote and indirect and *ultra vires*.

In purchasing land or erecting buildings, a corporation is not limited to such a quantity of land, or buildings of such a size, as are necessary for its present needs, but it may anticipate future necessities by reason of expected increase or extension of its business.³⁵ Neither a railroad or banking company, nor any other kind of corporation not created for the purpose of dealing in land, has any implied power to purchase or to acquire land merely for the purpose of holding and selling the same on speculation.³⁶

In *Williams v. Johnson*,³⁷ a railroad company became the owners of a large tract of land. This land was conveyed to trustees to develop the property under provisions by which the trust might last for almost a century. It was held that the arrangement contemplated a real estate business or speculation of which the railroad is sole owner. Such a scheme is not incidental to a right to sell the property. The deed of the railroad company was held beyond the power of the corporation to make and the trustees took no valid title under it. The court pointed out that the protection of a stockholder requires that the company be confined strictly to

³³ *Steinway v. Steinway & Sons*, 17 N. Y. Misc. 43, 40 N. Y. Supp. 718.

³⁴ *People ex rel. Moloney v. Pullman's Palace Car Co.*, 175 Ill. 125, 51 N. E. 664, 64 L. E. A. 366. A manufacturing corporation has no power under a charter provision giving it authority to hold such real estate as may be deemed necessary for the successful prosecution of its business, to purchase several hundred acres and subdivide the land not occupied by the plant into lots and blocks, erect houses, churches, school buildings, stores and rent them to

employees and others. It is deemed against the public policy of Illinois for a corporation to hold real estate beyond what is necessary for the transaction of its business.

³⁵ *People ex rel. Moloney v. Pullman's Palace Car Co.*, 175 Ill. 125, 51 N. E. 664, 64 L. E. A. 366.

³⁶ *Case v. Kelly*, 133 U. S. 21, 33 L. Ed. 513, 10 Sup. Ct. 216; *Pacific R. Co. v. Seeley*, 45 Mo. 212, 100 Am. Dec. 369; *Thweatt v. Bank of Hopkinsville*, 81 Ky. 1, 4 Ky. Law Rep. 557.

³⁷ 203 Mass. 544, 95 N. E. 90.

the business for which it was organized. He invests his money with a knowledge of the purpose for which the corporation is created. He does not invest in some other kind of enterprise, or authorize the managing officers to use the corporate property in a business foreign to that for which the company was established. The power to dispose of the land would not give the railroad company power to hold it for an unreasonably long time for speculation or investment. Massachusetts laws do not permit corporations to hold real estate for the purpose of profit.

Express prohibition against taking real property.—The capacity to take and hold land which was vested in corporations by the common law was considered contrary to the policy of English institutions, and was restricted by the statutes known as the statutes of mortmain, which prohibited corporations, whether ecclesiastical or lay, from taking and holding lands without license from the king or from parliament.³⁸ Except in Pennsylvania,³⁹ the English statutes of mortmain have not been regarded as in force in the United States,⁴⁰ but in many states there are constitutional or statutory provisions expressly restricting the power of corporations to take and hold land. In the absence of express restrictions there is no limitation upon the quantity or value of the property which a corporation may hold, other than such as results from the rule that it cannot hold property for a purpose which is foreign to the objects for which it was created.⁴¹

Prohibition against holding as a prohibition against taking.—In a leading case in Pennsylvania it was held that a statute or charter forbidding a corporation to “purchase *and* hold” real property was a prohibition against holding merely, and did not render void a conveyance of land to a corporation, but that the corporation acquired a title under the conveyance which it could convey to another, subject only to the right of the state to institute proceedings to defeat the title.⁴² Some cases hold, however, that a prohibition against holding land is a prohibition against taking

³⁸ 1 Bl. Com. 478; 2 Kent's Com. 282.

³⁹ *Leazure v. Hillegas*, 7 Serg. & R. (Pa.) 313.

⁴⁰ *White v. Howard*, 38 Conn. 342; *Page v. Heineberg*, 40 Vt. 81, 94 Am. Dec. 378. See *Sylvester Watts Smyth Realty Co. v. American Sure-*

ty Co., 292 Mo. 423, 238 S. W. 494; 8 Harvard Law Rev. 15.

⁴¹ *Sylvester Watts Smyth Realty Co. v. American Surety Co.*, 292 Mo. 423, 238 S. W. 494.

⁴² *Leazure v. Hillegas*, 7 Serg. & R. (Pa.) 313.

the same.⁴³ But although a corporation may exceed its powers in the purchase of land, that fact does not prevent title from passing to the corporation, and the corporation may transfer such title to another.⁴⁴

Personal property.—A corporation has the implied power to take personal property, including choses in action, by purchase, gift, or bequest, provided it is not taken for a purpose which is foreign to the objects for which it was created.

That a corporation has the capacity and power to take and hold personal property for purposes not foreign to the legitimate objects of its creation admits of no doubt.⁴⁵ On the other hand, a corporation has no power to purchase personal property for use in a business or transaction not authorized by its charter. Thus, a railroad company cannot purchase steamboats for the purpose of running a steamboat line beyond the terminus of its road.⁴⁶ A turnpike company cannot purchase horses and wagons for the purpose of transporting persons over its road.⁴⁷ Neither a manufacturing company, nor a bank, nor any other corporation not expressly authorized, can speculate by dealing in futures on the stock or produce exchange, through an agent or otherwise.⁴⁸

§ 56. **Power to take and hold property in trust, and to act as trustee.**—In the absence of express retraction, a corporation has the same capacity as a natural person to hold real or personal property in trust, provided its acting as trustee is not foreign to its objects. If property is conveyed, devised, or bequeathed in trust to a corporation which is without power to execute the trust, a court of equity will appoint a competent trustee to execute the same.

For several technical reasons it was formerly thought that corporations aggregate could not hold either real or personal property

⁴³ *In re McGraw's Estate*, 111 N. Y. 66, 19 N. E. 233, 2 L. R. A. 387; *Rivanna Nav. Co. v. Dawsons*, 3 Gratt. (Va.) 19, 22, 46 Am. Dec. 183.

⁴⁴ *State ex rel. Short v. Benevolent Investment & Relief Ass'n*, 107 Okla. 228, 232 Pac. 35, 37 A. L. R. 190; *State v. American Baptist Home Mission Soc.*, 96 W. Va. 447, 123 S. E. 440, 37 A. L. R. 200, 204n.

⁴⁵ *Bequest to corporation. In re Dol's Estate*, 182 Cal. 159, 187 Pac.

428; *In re Allen's Will*, 111 N. Y. Misc. 93, 181 N. Y. Supp. 398, aff'd 202 N. Y. App. Div. 810, 194 N. Y. Supp. 913.

⁴⁶ *Pearce v. Madison & I. R. Co.*, 21 How. (U. S.) 441, 16 L. Ed. 184; *Central Railroad & Banking Co. v. Smith*, 76 Ala. 572, 52 Am. Rep. 353; *Parish v. Wheeler*, 22 N. Y. 494.

⁴⁷ *Downing v. Mt. Washington Road Co.*, 40 N. H. 230.

⁴⁸ *Jemison v. Citizens' Sav. Bank of Jefferson*, 122 N. Y. 135, 25 N. E. 264, 9 L. R. A. 708, 19 Am. St.

in trust for another. One of the reasons given was that, since a corporation aggregate had no soul or conscience, no trust or confidence could be reposed in it, and a court of equity, which acted upon the conscience of a trustee in compelling the execution of a trust, could not compel it to execute the trust. Other reasons were that a corporation, being impersonal, could not be imprisoned for contempt in refusing to obey the decrees of the court, and could not take the oath required of trustees.⁴⁹ This view, however, has long since been abandoned, and it is now settled that corporations have the same capacity and power as a natural person to act as trustee, and to hold property in trust, provided the purpose is not foreign to the objects of its creation, and provided there are no charter or statutory prohibitions.⁵⁰

III. POWER TO ALIENATE OR INCUMBER PROPERTY.

§ 57. Power of alienation in general.—A corporation has, as an incident to its ownership of property, real or personal, the same capacity and power as a natural person to transfer or incumber the same, by absolute sale and conveyance or transfer, lease, mortgage, or pledge, provided the transfer or incumbrance is not prohibited by its charter or by statute, and is not foreign to the objects for which it was created.

Nothing is better settled than the doctrine that a corporation has the same capacity as a natural person to dispose of and convey its property, provided it does not do so for a purpose which is foreign to the objects for which it was created.⁵¹ A hotel company or other corporation which has constructed a building which is too large for its present need may lease the part which is not needed.⁵² And

Rep. 482; *McBoyle v. Union Nat. Bank*, 162 Cal. 277, 122 Pac. 458.

⁴⁹ 1 Bl. Com. 477. See *Minnesota Loan & Trust Co. v. Beebe*, 40 Minn. 7, 41 N. W. 232, 2 L. R. A. 418.

⁵⁰ *Vidal v. Girard's Ex'rs*, 2 How. (U. S.) 127, 11 L. Ed. 205; *Jones v. Habersham*, 107 U. S. 174, 189, 27 L. Ed. 401, 2 Sup. Ct. 336; *Kerens v. St. Louis Union Trust Co.*, 283 Mo. 601, 223 S. W. 645, 11 A. L. R. 288.

⁵¹ *Joy v. Jackson & M. Plank Road Co.*, 11 Mich. 164.

⁵² *Simpson v. Directors of West-*

minster Palace Hotel Co., 8 H. L. Cas. 712.

A corporation chartered to manufacture railway cars, and authorized to purchase and hold such real estate as may be necessary for the prosecution of its business, and whose business is large and increasing, may purchase land and erect a large office building, in anticipation of its future needs, and may rent such portions of the same as are not presently needed. *People ex rel. Moloney v. Pullman's Palace Car Co.*, 175 Ill. 125, 51 N. E. 664, 64 L. R. A. 366.

a railroad company owning steamboats for the purpose of maintaining a ferry in connection with its road is not bound to allow them to lie idle when not needed in its business, but may lease them when not in use, and thus avoid their lying unemployed and unprofitable.⁵³

§ 58. Restrictions upon the power to give away, alienate or incumber property.

Gifts and subscriptions.—Ordinarily, a gift of its property by a corporation not created for charitable purposes is in violation of the rights of its stockholders, and is *ultra vires*, however worthy of encouragement or aid the object of the gift may be.⁵⁴ A business corporation is organized and carried on primarily for the profit of the stockholders. The discretion of the directors does not extend to the devotion of capital or profits to humanitarian purposes to benefit mankind at the expense of the stockholders.⁵⁵ Thus, it has been held that it is *ultra vires* for a national bank to make a donation for the purpose of inducing a manufacturing company not to remove its plant from the city,⁵⁶ or for an insurance company to voluntarily pay an ex-president a large sum of money for past services, which it is under no legal duty to pay, and which would not constitute a legal consideration for a promise to pay.⁵⁷

There may be circumstances, however, under which a gift of property by a corporation would be a legitimate means of increasing or carrying on its business, and in such a case it would not be *ultra vires*. There is a clear distinction between a pure gift and a donation made with a view of receiving material benefits therefrom. It has been held, for example, that an insurance company, for the purpose of increasing its business, may properly pay a customer a loss not covered by his policy, and for which it could not be held liable;⁵⁸ that a corporation may pay extra wages to its

⁵³ *Forrest v. Manchester, S. & L. Ry. Co.*, 30 Beav. 40; *Brown v. Winisimmet Co.*, 11 Allen (Mass.) 326.

⁵⁴ *Davis v. Old Colony R. Co.*, 131 Mass. 271, 41 Am. Rep. 221. But see 7 Minneapolis Law Rev. 408; 34 Harvard Law Rev. 555.

⁵⁵ *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N. W. 668, 3 A. L. R. 413.

⁵⁶ *McCrory v. Chambers*, 48 Ill. App. 445. Bank charters are construed strictly and subscriptions by

banks to funds for bringing new industries to the locality and so increasing business are *ultra vires*. *Holt v. Winfield Bank*, 25 Fed. 812. Cp. as to business corporations, *Huntington Brewing Co. v. McGrew*, 64 Ind. App. 273, 112 N. E. 534.

⁵⁷ *Beers v. New York Life Ins. Co.*, 66 Hun (N. Y.) 75, 20 N. Y. Supp. 788.

⁵⁸ *Tauton v. Royal Ins. Co.*, 2 Hem. & M. 135. See L. R. A. 1916B 1009 note, for cases illustrating extent to which promotion or aid of

workmen or other employees out of its undivided profits, for the purpose of advancing its interests.⁵⁹ In a Missouri case it was held that the payment of a bonus of one-third the net profits of a corporation to officers and employees upon a previous understanding that the bonus would be paid if the corporation continued prosperous was not a fraud upon dissenting stockholders.⁶⁰ So the payment of pensions or allowances to retiring employees has been held within the implied powers of corporations. A railroad company may pay for the services of a physician and nurse for an employee injured in the course of his employment;⁶¹ and a manufacturing company may give away some of its goods for the purpose of advertising; or, to gain the good will of its employees, may properly contribute to the support of the library, church and schoolhouse of the factory village.⁶² Business and manufacturing corporations may contribute funds to assist colleges and universities in the training of possible prospective employees and in scientific research, where in the discretion of the directors the advantage to the corporation may be direct and substantial, and not too speculative or remote.⁶³ A land company may make a donation for the purpose of procuring the erection of a college,⁶⁴ or the construction of a railroad⁶⁵ or bridge.⁶⁶ Corporations whose purpose is the improvement and sale of realty are treated as having very extensive implied powers in this regard. And according to the better opinion, though there is a decision of the Massachusetts court to the contrary, hotel or trading companies, street-railroad companies, and other corporations whose business will be increased by the holding of a convention, fair, festival, or the like, in the

collateral, tributary projects is within incidental powers.

⁵⁹ *Hampson v. Price's Patent Candle Co.*, 45 Law J. Ch. 437.

⁶⁰ *Putnam v. Juvenile Shoe Corp.*, 307 Mo. 74, 269 S. W. 593, 40 A. L. R. 1412-1424n. Such payments tend to stimulate loyalty, faithfulness and energy and gives employees a real interest in the business. If the amount of the bonus is not unreasonably large, it tends to increase profits.

⁶¹ *Toledo, W. & W. Ry. Co. v. Rodrigues*, 47 Ill. 188, 95 Am. Dec. 484.

⁶² *Steinway v. Steinway & Sons*, 17 N. Y. Misc. 43, 40 N. Y. Supp. 718.

⁶³ *Evans v. Brunner, Mond & Co.*, L. R. [1921] 1 Ch. Div. 359, 11 Brit. Rul. Cas. 297, 307n. *Armstrong Cork Co. v. H. A. Meldrum Co.*, 285 Fed. 58; 7 Minn. Law Rev. 408; 1 Boston Uni. Law. Rev. 99; 34 Harv. Law Rev. 555; 2 Fletcher, Corporations, 2148.

⁶⁴ *Whetstone v. Ottawa University*, 13 Kan. 320; *Sherman Center Town Co. v. Russell*, 46 Kan. 382, 26 Pac. 715.

⁶⁵ *Vandall v. South San Francisco Dock Co.*, 40 Cal. 83; *McGeorge v. Big Stone Gap Imp. Co.*, 57 Fed. 262.

⁶⁶ *Ft. Worth City Co. v. Smith Bridge Co.*, 151 U. S. 294, 38 L. Ed. 167, 14 Sup. Ct. 339.

place in which they are located, may donate money or property towards the payment of the expenses of the same.⁶⁷

§ 59. Alienation of entire property.—A purely private business corporation, like a manufacturing or trading company, which is not given the right of eminent domain, and which owes no special duties to the public, may sell and convey absolutely the whole of its property, when the exigencies of its business require it to do so, or when the circumstances are such that it can no longer profitably continue its business.⁶⁸ A minority of stockholders cannot hold the majority to an unprofitable and hopeless enterprise. In *Bowditch v. Jackson Co.*,⁶⁹ the New Hampshire court holds that a going business corporation can be closed out and dissolved by the majority of its stockholders and against the protest of the minority. The court says: "The plain common sense of the matter is that this is a business venture, to be carried on as such so long as it appears to be good business judgment to do so. The majority can close out the affairs of the company when it can no longer make a reasonable profit. If the majority may sell to prevent greater losses, why may they not also sell to make greater gains? The question is one of future prospects."

The general rule however is, in the absence of statute, that a majority of the stockholders of a corporation, have no power to sell

⁶⁷ *Richelieu Hotel Co. v. International Military Encampment Co.*, 140 Ill. 248, 29 N. E. 1044, 33 Am. St. Rep. 234; *Temple St. Cable Ry. Co. v. Hellman*, 103 Cal. 634, 37 Pac. 530; *State Board of Agriculture v. Citizens' St. Ry. Co.*, 47 Ind. 407, 17 Am. Rep. 702. *Contra*, *Davis v. Old Colony R. Co.*, 131 Mass. 271, 41 Am. Rep. 221.

⁶⁸ If a corporation is losing money the directors may sell out the company's business and liquidate its affairs. This doctrine, as announced in *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.) 393, 66 Am. Dec. 490, has been generally followed. *O'Brien v. O'Brien*, 246 Mass. 411, 141 N. E. 236; *Geddes v. Anaconda Copper Min. Co.*, 254 U. S. 590, 65 L. Ed. 425, 429, 41 Sup. Ct. 209; *Marks v. Merrill Paper Co.*, 188 Fed. 850; *Stebbins v. Michigan Wheelbarrow & Truck Co.*, 191 Fed. 238; *Thea v. Newton*, 262 Fed. 345; *Raymond v. Security Trust & Life Ins. Co.*, 111 N. Y. App. Div. 191, 97

N. Y. Supp. 557; *State v. Western Irrigating Canal Co.*, 40 Kan. 96, 19 Pac. 349, 10 Am. St. Rep. 166; *Dupree v. Boston Water Power Co.*, 114 Mass. 37; *Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co.*, 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448; *Phillips v. Providence Steam-Engine Co.*, 21 R. I. 302, 43 Atl. 598, 45 L. R. A. 560.

⁶⁹ 76 N. H. 351, 82 Atl. 1014, L. R. A. 1917A 1174, Ann. Cas. 1913A 366: "The action taken by a majority of stockholders of the Jackson Company whereby, as part of the process of winding up the company, they voted to sell all its property to the Nashua Company, was within the power impliedly given to them when the company was formed." This sale was part of the process of winding up and was fair and free from fraud. See acc. *Beidenkopf v. Des Moines Life Ins. Co.*, 160 Iowa 629, 142 N. W. 434, 46 L. R. A. (N. S.) 290.

and convey its entire property, and discontinue its business, against the dissent of the minority, if the sale is not required by the exigencies of its business; and, if they attempt to do so, a dissenting stockholder may maintain a suit to enjoin the transfer.⁷⁰ Neither the directors nor a majority of the stockholders of a prosperous and going corporation, nor both together, have power to dispose of the entire property of the corporation, or even so much of it as renders the corporation unable to continue business.

In recent years statutes authorizing such disposition by the consent of a majority, or two-thirds or three-quarters of the stockholders of a solvent, going concern have become common.⁷¹ It has been found that injustice may result to the bulk of the stockholders arising from the want of power in the corporation to sell out its business, or an essential part of it, on terms deemed advantageous by the majority. This gave a strangle hold to the minority dissenting to compel the majority to buy them out on their own terms in order to secure unanimous consent. Hence legislation has been passed in a number of states to enable a majority (sometimes of two-thirds) to sell, if that is deemed the best policy, and at the same time protect the minority, if they regard the sale as opposed to their interest. This is accomplished in New York by giving a summary method of ascertaining the value of the stock of the dissenting stockholders, who are entitled to the appraised value thereof. The legislature may impose as a condition of the right to sell its property or business, that the corporation shall

⁷⁰ *Kean v. Johnson*, 9 N. J. Eq. 401; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Ernest v. Nicholls*, 6 H. L. Cas. 401; *Price v. Holcomb*, 89 Iowa 123, 56 N. W. 407; *Superior Min. Co. v. White Coal Co.*, 214 Ill. App. 381; *Wortman v. Luna Park Co.*, 61 Mont. 89, 201 Pac. 570; *Murrin v. Archbald Consol. Coal Co.*, 232 N. Y. 541, 134 N. E. 563; *In re De Camp Glass Casket Co.*, 272 Fed. 558; *Des Moines Life & Annuity Co. v. Midland Ins. Co.*, 6 Fed. (2d) 228. It requires unanimous consent of shareholders for corporation to sell out its business. *Jones v. Missouri Edison Elec. Co.*, 144 Fed. 765, 777; *American Seating Co. v. Bulard*, 290 Fed. 896, 901. See Warren,

Voluntary Transfer, 30 Harvard Law Rev. 364.

⁷¹ *Allied Chemical & Dye Corporation v. Steele & Tube Co. of America*, 14 Del. Ch. 1, 120 Atl. 486, 491. Under the Delaware statute a majority of stockholders may sell the assets and business. It has been held that if the majority abuse their statutory power to advantage themselves at the expense of the minority, their conduct is fraudulent and relief may be had in equity. See note, 33 Yale Law Journal 436.

Mitchell v. Des Moines & F. D. R. Co., 270 Fed. 465 (sale under statutory power [Iowa] by vote of $\frac{3}{4}$ of stock); *Koehler v. St. Mary's Brewing Co.*, 228 Pa. 648, 77 Atl. 1016, 1017, 139 Am. St. Rep. 1024.

purchase the stock of objecting stockholders at a value to be fixed by appraisers.⁷²

The rule against alienation that will result in termination of the business, applies to leases as well as to absolute conveyances. A majority of the stockholders of a corporation may lease the entire property of the corporation whenever the exigencies of the business require such a lease.⁷³ But they cannot do so against the dissent of the minority when it is not required by the exigencies of the business.⁷⁴ A corporation has no power to lease its property when the lease is inconsistent with its charter and the object for which it was created.⁷⁵

IV. POWERS WITH RESPECT TO CONTRACTS.

§ 60. In general.—In the absence of restrictions in its charter or by statute, a corporation has the same power as a natural person to enter into contracts, provided they are necessary or reasonably incidental to the business for which it was created; but it has no authority to enter into any contract, however beneficial it may be, which is foreign to the objects for which it was created.

The general rule is that a corporation, in the absence of express restrictions, has the same power as a natural person to enter into any contract which is necessary to enable it to carry on the business and accomplish the objects for which it was created, or which, though not necessary, in the sense of indispensable, is reasonably incidental to such business.⁷⁶ On the other hand, a corporation

⁷² *In re Timmis*, 200 N. Y. 177, 93 N. E. 522; *In re Bickerton*, 196 N. Y. App. Div. 231, 187 N. Y. Supp. 267; *Bickerton v. New York Theatre Co.*, 232 N. Y. 1, 133 N. E. 41.

⁷³ *Featherstonhaugh v. Lee Moor Porcelain Clay Co.*, L. R. 1 Eq. 318; *Bartholomew v. Derby Rubber Co.*, 69 Conn. 521, 38 Atl. 45, 61 Am. St. Rep. 57. See also, *Plant v. Macon Oil & Ice Co.*, 103 Ga. 666, 30 S. E. 567. A private corporation has the right temporarily to lease or rent its property when the purpose is not an abandonment of its enterprise, but to meet an urgent necessity of raising funds to enable it to conduct its business profitably.

⁷⁴ *Small v. Minneapolis Electro-Matrix Co.*, 45 Minn. 264, 47 N. W. 797 (lease for 25 years held *ultra*

vires); *Copeland v. Citizens' Gas Light Co.*, 61 Barb. (N. Y.) 60.

⁷⁵ *Dow v. Northern R. Co.*, 67 N. H. 1, 36 Atl. 510.

The N. R. R. was chartered to construct and keep in use a railroad from Concord to Lebanon. Two thirds of the stockholders approved a lease to the B. & L. for 99 years. It was held that such lease was invalid against minority dissenting stockholders as a change of corporate purpose. *Doe C. J.* needlessly placed his decision on a disregard of the corporate entity doctrine. See 8 Harvard Law Rev. 295.

⁷⁶ *London & N. W. Ry. Co. v. Price*, 11 Q. B. Div. 485; *Richelieu Hotel Co. v. International Military Encampment Co.*, 140 Ill. 248, 29 N. E. 1044, 38 Am. St. Rep. 234;

has no power to enter into any contract which is foreign to the objects for which it was created. A corporation created for the purpose of manufacturing and leasing railway carriages, etc., cannot lawfully purchase a concession for the construction of a railroad, and contract for the construction and operation of the same.⁷⁷ Nor can a corporation created for the purpose of constructing and maintaining a toll road engage in the business of transporting passengers over the road for hire, or contract for the purchase of vehicles for such purpose.⁷⁸ And in no case has a corporation of any kind the power to borrow money for a purpose which is foreign to the objects for which it was created. As was said in a New York case, the power of a corporation to borrow money is not a principal power, but an incidental power.⁷⁹

§ 61. Power to execute and issue bonds.—In the absence of express restrictions, a corporation has the implied power to execute and issue bonds for legitimate corporate purposes, and it may issue them in any form not prohibited by law.

Whenever a corporation has the power to borrow or raise money, to purchase property, to contract for services or labor, to pay debts or take up bonds of another corporation, or to otherwise contract a debt, it has the implied power, as an incident thereto, to issue its bonds in payment or as security, provided it violates no express or implied prohibition or restriction in its charter or any statute.⁸⁰

Having the power to issue negotiable paper, a corporation may issue negotiable bonds. And bonds issued by a corporation, although under seal, are to be regarded as negotiable, whenever an intention to make them so appears from the form in which they

Bradbury v. Boston Canoe Club, 153 Mass. 77, 26 N. E. 132; Morville v. American Tract Soc., 123 Mass. 137, 25 Am. Rep. 40; Leslie v. Lorillard, 110 N. Y. 519, 18 N. E. 363, 1 L. R. A. 456; Woods Lumber Co. v. Moore, 183 Cal. 497, 191 Pac. 905, 11 A. L. R. 549 (guaranty of contract by moving picture producer for purchase of lumber needed to produce film, where corporation had a contract to supply costumes to producer).

⁷⁷ Ashbury Railway Carriage & Iron Co. v. Riche, L. R. 7 H. L. 653.

⁷⁸ Downing v. Mt. Washington Road Co., 40 N. H. 230.

⁷⁹ Beers v. Phoenix Glass Co., 14 Barb. (N. Y.) 358, 362. See also,

Bradley v. Ballard, 55 Ill. 413, 8 Am. Rep. 656; Trenton Mut. Life & Fire Ins. Co. v. McKelway, 12 N. J. Eq. 133; In re National Permanent Ben. Bldg. Soc., 5 Ch. App. 309; State v. Oberlin Building & Loan Ass'n, 35 Ohio St. 258.

⁸⁰ Royal British Bank v. Turquand, 5 El. & Bl. 248; Com. v. Smith, 10 Allen (Mass.) 448, 455, 87 Am. Dec. 672; Mead v. New York, H. & N. R. Co., 45 Conn. 199; Nelson v. Hubbard, 96 Ala. 238, 11 So. 428, 17 L. R. A. 375; Barry v. Merchants' Exch. Co., 1 Sandf. Ch. (N. Y.) 280; North Hudson Mut. Building & Loan Ass'n v. First Nat. Bank of Hudson, 79 Wis. 31, 47 N. W. 300, 11 L. R. A. 845.

are executed, and the manner in which they are put in circulation.⁸¹ A corporation cannot lawfully issue bonds for a purpose which is foreign to the business or objects for which it was created.⁸² Thus in the leading Texas case of *Northside Ry. Co. v. Worthington*,⁸³ the *Fort Worth City Company* was organized for the purpose of "the purchase, subdivision and sale of lands in cities, towns, and villages." The *Northside Railway Co.* was organized for "the construction and maintenance of street railways." The two companies joined in a contract for the issue of joint bonds and borrowed a sum of money to be divided between them. Each corporation thus became surety for the other for the amount received by the other. It was held in a suit on the bonds that the bonds were not void as a whole, but that each company was liable for such portion of the bonded debt as the amount received by it bore to the amount raised. It was not liable for more than its proportionate amount. Neither of these companies had the power to extend its credit to promote the interests of the other. The issuance by the two companies of joint bonds, dividing the proceeds, was equivalent to borrowing the money to be divided between them, each to be the surety of the other. The law does not recognize the operation of street railroads as a usual means of carrying out the purpose of a company organized to purchase and subdivide lands, and to sell them in city lots. A corporation may exercise such powers as are reasonably necessary to accomplish its purposes, if the means be such as are usually resorted to and a direct method of accomplishing the purpose. If they are unusual and tend only in an indirect manner to promote its interests, they are *ultra vires*.

A street railroad company has no implied power to engage in the business of developing a tract of land along its line for residential and business purposes. Conversely, a land company organized to

⁸¹ *In re Blakely Ordinance Co.*, 3 Ch. App. 154; *American Nat. Bank v. American Wood Paper Co.*, 19 R. I. 149, 32 Atl. 305, 29 L. R. A. 103, 61 Am. St. Rep. 746; *White v. Vermont & M. R. Co.*, 21 How. (U. S.) 575, 16 L. Ed. 221; *Mercer County v. Hackett*, 1 Wall. (U. S.) 83, 17 L. Ed. 548; *Lehman Bros. v. Tallassee Mfg. Co.*, 64 Ala. 567.

⁸² *Smith v. Alabama Life Insurance & Trust Co.*, 4 Ala. 558; *Northside Ry. Co. v. Worthington*, 88 Tex. 562, 30 S. W. 1055, 53 Am. St. Rep. 778.

⁸³ 88 Tex. 562, 30 S. W. 1055, 53 Am. St. Rep. 778; *Western Maryland R. Co. v. Blue Ridge Hotel Co.*, 102 Md. 307, 62 Atl. 351, 2 L. R. A. (N. S.) 887, 111 Am. St. Rep. 362. See *Machen, Corporations*, sec. 87; 7 R. C. L. 546, 547. Cp. *Richardson v. Bermuda Land & Live Stock Co.*, — Tex. Comm. App. —, 231 S. W. 337. A land and live stock company may aid on securing improved transportation facilities to and from its land, which would increase its business.

develop a suburban tract has no implied power to engage in the business of operating a street railroad though such operation would incidentally benefit its land project.

It was argued that the act of these companies in issuing the bonds was in furtherance of the authorized business of each and for the accomplishment of their legitimate objects. The benefit to the real estate company from the railroad seems pretty direct. The court seems to overlook the distinction between signing bonds as surety or lending credit, and engaging in the business. Whether such assistance is reasonably conducive to the proper conduct of the legitimate business depends upon circumstances.

§ 62. Power to become surety or guarantor.—As a general rule, a contract of suretyship or guaranty is within the powers of a corporation only when, under the circumstances, it is a necessary or proper means of accomplishing a purpose authorized by its charter.

Ordinarily, in the absence of express authority, a corporation has no power to enter into a contract as surety or guarantor, and thus lend its credit to another corporation or person, for such an act is not usually necessary or proper in the conduct of its business.⁸⁴ In *Wm. Filene Sons Co. v. Gilchrist Co.*,⁸⁵ the Filene Company made a lease to the Butler Company which the Gilchrist Company guaranteed. It was held that a corporation created under the Massachusetts statutes for the purpose of "buying, selling, jobbing, manufacturing, and dealing in dry goods and general merchandise, and carrying on the business of a department store," is without power to guarantee a lease made by another corporation having no connection with its business. The statute provided that a corporation shall not direct its operations or appropriate its funds to any other purpose than that specified in its agreement or association or its charter." The guaranty of a lease by another

⁸⁴ In re Gilchrist Co., 278 Fed. 235; Traylor Engineering & Mfg. Co. v. United States Shipping Board Emergency Fleet Corp., 277 Fed. 248; In re John B. Rose Co., 275 Fed. 416; 30 Yale Law Journal 89; W. C. Bowman Lumber Co. v. Piereson, 110 Tex. 543, 221 S. W. 930, 11 A. L. R. 547.

⁸⁵ 278 Fed. 235, 240; s. c., 284 Fed. 664. The guaranteeing to the lessor of the performance of the conditions and covenants of a lease

by another corporation with which the guarantor has nothing to do, and involving a possible liability dangerously large was held foreign to the purposes of a corporation organized to carry on a dry goods business. Such a guaranty is not fair to the stockholders of the guarantor or its creditors. It is not within the scope of the business in which the former have invested, nor within the legitimate risks to which the creditors have extended credit.

corporation having no connection with its business was not reasonably incidental to its business nor within the scope of its powers. The objection to such a contract "is that it risks the funds of the company in a different enterprise and business under the control of another and different person or corporation, contrary to what its stockholders, its creditors, and the state have the right from its charter to expect."⁸⁶

The power, however, exists in the case of corporations, not expressly authorized, whenever it is necessary to enable them to accomplish the objects for which they are created, or whenever the particular transaction is reasonably necessary or proper in the conduct of their business.

Whether a contract of guaranty will advance the corporate interests is primarily within the discretion of the officers of the corporation and courts will hold the contract *ultra vires* only when it clearly appears to be foreign to the business authorized.⁸⁷ The courts are becoming more liberal in allowing a corporation implied power to stimulate its business by assisting customers with guarantees which seems to be needed for the successful prosecution of their business upon which their patronage depends.⁸⁸

§ 63. Power to enter into copartnership.—As a general rule, a corporation has no power to enter into a copartnership, unless authority is expressly conferred. The rule, however, does not

⁸⁶ Humboldt Min. Co. v. American Manufacturing, Mining & Milling Co., 62 Fed. 356; W. C. Bowman Lumber Co. v. Pierson, 110 Tex. 543, 221 S. W. 930, 11 A. L. R. 547; note, 30 Yale Law Journal 89; Western Maryland R. Co. v. Blue Ridge Hotel Co., 102 Md. 307, 62 Atl. 351, 2 L. R. A. (N. S.) 887, 111 Am. St. Rep. 362.

⁸⁷ M. Burg & Sons v. Twin City Four Wheel Drive Co., 140 Minn. 101, 167 N. W. 300 (a corporation has power to guarantee a salesman's bill for furniture which he wishes to buy in order to induce the salesman to remain with the company, where his services are important in the furtherance of its business); Tod v. Kentucky Union Land Co., 57 Fed. 47; Green Bay & M. R. Co. v. Union Steamboat Co., 107 U. S. 98, 27 L. Ed. 413, 2 Sup. Ct. 221; Low v. California Pac. R. Co., 52 Cal. 53, 28 Am. Rep. 629; Timm v. Grand

Rapids Brewing Co., 160 Mich. 371, 125 N. W. 357, 27 L. R. A. (N. S.) 186; State Bank of Fairfax v. Pacific Elevator Co., 159 Minn. 94, 198 N. W. 304 (a corporation may guarantee the obligations of its subsidiary companies, and of others where the purpose is to promote or protect its own rights, and not merely to aid the primary obligor). See also, General Inv. Co. v. Bethlehem Steel Corp., 248 Fed. 308; 3 Wisconsin Law Review 48.

⁸⁸ A moving picture producer contracted with the D Company for the theatrical costumes and with the P for lumber needed in the production of a picture. P refused further credit and the D Company guaranteed payment of all bills P had or would have against the producer. It was held that the guaranty was within the implied powers of the D Company and not *ultra vires*, as it was directly interested in the suc-

prevent the law from imposing upon a corporation the liability of a partner. Nor does it apply where the sole management of the business of the copartnership is intrusted to the corporation, or prevent a corporation from owning property in common with another, and making joint contracts.

Unless the power is expressly conferred, a corporation, as a general rule, has no power to enter into a contract of partnership with another corporation or an individual, for this is considered to involve too great a delegation of the power of management which should be exercised by the board of directors.⁸⁹ As the Tennessee Supreme Court has said: "If a corporation be a member of a partnership, it may be bound by any other member of the association, and in so doing he would act, not as an officer or agent of the corporation, and by virtue of authority received from it, but as a principal in an association in which all are equal, and each capable of binding the society by his acts. The whole policy of the law creating and regulating corporations, looks to the exclusive management of the affairs of each corporation by the officers provided for or authorized by its charter. This management must be separate and exclusive, and any arrangement by which the control of the affairs of the corporation should be taken from its stockholders and the authorized officers and agents of the corporation would be hostile to the policy of our general incorporation acts."⁹⁰

This rule does not apply when such a contract is expressly authorized by its charter or by statute, as it may be.⁹¹ It has even been held that a corporation has implied power to enter into a temporary partnership in order to realize on a stock of goods taken over as security for indebtedness.⁹² Even though the agreement of partnership may be *ultra vires* and unenforceable as to the future, yet this does not prevent *the law* from imposing upon a corporation

cess of its customer, the producer. Woods Lumber Co. v. Moore, 183 Cal. 497, 191 Pac. 905, 11 A. L. R. 549, note, p. 554; 19 Mich. Law Rev. 216; 30 Yale Law Journal 89.

⁸⁹ Hoshier-Platt Co. v. Miller, 238 Mass. 518, 131 N. E. 310; Whittenton Mills v. Upton, 10 Gray (Mass.) 582, 71 Am. Dec. 681; Mallory v. Hanaur Oil-Works, 86 Tenn. 598, 8 S. W. 396; Boyd v. American Carbon Black Co., 182 Pa. St. 206, 37 Atl. 937. See Merchants' Nat. Bank of Cincinnati v. Wehrmann, 202 U. S. 295, 50 L. Ed. 1036, 26 Sup. Ct.

613. Contra, Allen v. Woonsocket Co., 11 R. I. 288.

⁹⁰ Mallory v. Hanaur Oil-Works, 86 Tenn. 598, 8 S. W. 396; Machen, Corporations, sec. 86.

⁹¹ Butler v. American Toy Co., 46 Conn. 136; Mervyn Inv. Co. v. Biber, 184 Cal. 637, 194 Pac. 1037; Haiku Sugar Co. v. Johnstone, 249 Fed. 103 (statute).

⁹² Snow Hill Banking & Trust Co. v. D. J. Odom Drug Co., 188 N. C. 672, 125 S. E. 394, 37 A. L. R. 1101 note; 9 Minnesota Law Review 381.

the liability of a partner as to third persons by reason of engaging in business as a partner.⁹³ So in an executed partnership transaction, the corporation must account to its copartner for profits received.⁹⁴ An individual or a corporation cannot escape liability to third persons as a partner on the ground that the corporation was incapable of entering into the relation.⁹⁵ So a corporation and the individual may enforce joint contracts against third persons, irrespective of the power of the corporation to bind itself to form a partnership.⁹⁶

Corporation having sole management.—The reason for the rule preventing a corporation from entering into a partnership, and therefore the rule itself, does not apply to a partnership agreement between a corporation and an individual, by which the entire management of the business is intrusted solely to the corporation, as in the case of a contract between a corporation, created for the purpose of buying and selling land, and an individual, to buy and sell certain lands and share the profits and losses.⁹⁷ An agreement to share net profits and losses in a joint enterprise which would have created a partnership if made by individuals may be upheld as a so-called "joint adventure" when a corporation is a party where no actual intent to create a partnership is expressed.⁹⁸

§ 64. Mode of contracting.—Corporate seal.—Unless the charter of a corporation or some statute requires it to contract in some particular form or manner, it may contract through its authorized agents in the same form and manner as a natural person.

Contracts under seal.—A corporation may always contract under the corporate seal, so as to make the contract a deed or specialty.⁹⁹ In some of the early cases the English doctrine as to the necessity for the use of the corporate seal in contracts by corporations was recognized in the United States; but it has long since been abandoned, and the rule is now well settled that, in the

⁹³ *Cleveland Paper Co. v. Courier Co.*, 67 Mich. 152, 34 N. W. 556; *French v. Donohue*, 29 Minn. 111, 12 N. E. 354; *Mervyn Inv. Co. v. Biber*, 184 Cal. 637, 194 Pac. 1037. Corporation may be held liable as a partner to third parties.

⁹⁴ *Boyd v. American Carbon Black Co.*, 182 Pa. St. 206, 37 Atl. 937.

⁹⁵ *Moore v. Thorpe*, 133 Minn. 244, 249, 158 N. W. 235.

⁹⁶ *Wilson v. Carter Oil Co.*, 46 W. Va. 469, 33 S. E. 249.

⁹⁷ *Bates v. Coronado Beach Co.*, 109 Cal. 160, 41 Pac. 855.

⁹⁸ *Luhrig Collieries Co. v. Interstate Coal & Dock Co.*, 281 Fed. 265.

⁹⁹ *Commonwealth v. Smith*, 10 Allen (Mass.) 448, 87 Am. Dec. 672.

absence of charter or statutory provisions to the contrary, a corporation may appoint an agent without the use of its seal, and may, acting by such agent, enter into a simple contract in writing or an oral contract, provided the subject-matter of the contract is within its powers, whenever a natural person could enter into such a contract. In other words, any contract whatever, within the powers of a corporation, if it can be made by a natural person without a seal, may be so made by the corporation, unless a seal is expressly required by the charter of the corporation or some statute.¹⁰⁰

A conveyance of land by a corporation must be under the corporate seal, unless it is rendered unnecessary by some express statutory provision.¹⁰¹ In order that an instrument executed in the name of a corporation may be the deed of the corporation, the corporate seal must be properly affixed thereto. The seal affixed must be the seal of the corporation,—the seal adopted, regularly or for the occasion, as the corporate seal,¹⁰²—and not merely the private seal of the officer or agent executing the instrument;¹⁰³ but a recital in the execution clause may show that a mere scroll was adopted by the corporation as its seal for the purpose, and affixed as the seal of the corporation and not as the personal or private seal of the officer.¹⁰⁴ The seal must be affixed by an authorized officer or agent. “The mere fact that a deed has the corporate seal

¹⁰⁰ *Bank of Columbia v. Patterson's Adm'r*, 7 Cranch (U. S.) 299, 3 L. Ed. 351; *Crawford v. Longstreet*, 43 N. J. Law, 325; *Pixley v. Western Pac. R. Co.*, 33 Cal. 183, 91 Am. Dec. 623; *Muscatine Water Co. v. Muscatine Lumber Co.*, 85 Iowa 112, 39 Am. St. Rep. 284; *Grand Lodge K. of P. v. State Bank of Florida*, 79 Fla. 471, 84 So. 528; *Commercial Security Co. v. Modesto Drug Co.*, 43 Cal. App. 162, 184 Pac. 964.

¹⁰¹ *Garrett v. Belmont Land Co.*, 94 Tenn. 459, 29 S. W. 726; *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454; *Bentley v. Zelma Oil Co.*, 76 Okla. 116, 184 Pac. 131, 141; *Emory v. Bailey*, 111 Tex. 337, 234 S. W. 660, 18 A. L. R. 901.

¹⁰² *Danville Seminary v. Mott*, 136 Ill. 289, 28 N. E. 54; *Regents of University of Michigan v. Detroit Young Men's Soc.*, 12 Mich. 138; *Brinley v. Mann*, 2 Cush. (Mass.) 337; *Randall v. Van Vechten*, 19

Johns. (N. Y.) 60, 10 Am. Dec. 193. See *Cannon v. Gorham*, 136 Ga. 167, 71 S. E. 142, Ann. Cas. 1912C 39, 42 note, what is a sufficient corporate seal.

¹⁰³ *Regents of University of Michigan v. Detroit Young Men's Soc.*, 12 Mich. 138; *Bank of Metropolis v. Guttschlick*, 14 Pet. (U. S.) 19, 10 L. Ed. 335; *Randall v. Van Vechten*, 19 Johns. (N. Y.) 60, 10 Am. Dec. 193; *Taft v. Brewster*, 9 Johns. (N. Y.) 334, 6 Am. Dec. 280; *Brinley v. Mann*, 2 Cush. (Mass.) 337, 48 Am. Dec. 669.

¹⁰⁴ *Campbell v. McLaurin Inv. Co.*, 74 Fla. 501, 77 So. 277; *Boone v. Jenkins*, 147 Ga. 812, 95 S. E. 707. The instrument recited that it was executed by the corporation under “its hand and seal,” thereby showing that it was intended that the word “Seal,” included in the brackets following the name of the corporation as signed by the secretary and treasurer, should operate as the seal of the corporation.

attached, does not make it the act of the corporation, unless the seal was placed to it by some one duly authorized." ¹⁰⁵ Authority to execute a deed for a corporation need not be conferred by an instrument under seal.

If an instrument purports to have been executed by a corporation, and the corporate seal is affixed, it will be presumed, in the absence of evidence to the contrary, that it is the proper seal of the corporation, ¹⁰⁶ and that it was affixed by a duly-authorized officer or agent; ¹⁰⁷ but the presumption may be rebutted by showing that it was not so affixed, and in such a case the instrument is not the deed of the corporation. ¹⁰⁸ The seal need not necessarily be affixed to the deed by the hand of the officer executing it, but it may be affixed by his direction. Thus, it was held sufficient when a *facsimile* of the seal of a corporation was impressed by the printer upon bonds to be issued by the corporation, by direction of the officers of the corporation, and the officers subsequently signed and issued the bonds. ¹⁰⁹ In the absence of a charter or statutory provision to the contrary, a corporation, like an individual, may adopt any seal which is convenient for the occasion, and may alter or renew the same at pleasure. ¹¹⁰

When a charter of a corporation provides that contracts on behalf of the corporation shall be made by certain officers, or by a certain number of officers, and the provision is not merely direc-

¹⁰⁵ *Koehler v. Black River Falls Iron Co.*, 2 Black (U. S.) 715, 17 L. Ed. 339.

¹⁰⁶ *Jacksonville, M. P. Ry. & Nav. Co. v. Hooper*, 160 U. S. 514, 40 L. Ed. 515, 16 Sup. Ct. 379; *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454; *Dart v. Hughes*, 49 Colo. 465, 469, 109 Pac. 952, 953. See *Fletcher, Corporations*, secs. 751, 757, 758.

¹⁰⁷ *Little Sawmill Val. Turnpike or Plank Road Co. v. Federal St. & P. V. Passenger Ry. Co.*, 194 Pa. St. 144, 45 Atl. 66, 75 Am. St. Rep. 690; *Macknight v. Davitt*, 37 Cal. App. 720, 174 Pac. 77.

¹⁰⁸ *Koehler v. Black River Falls Iron Co.*, 2 Black (U. S.) 715, 17 L. Ed. 339. And see *Hoyt v. Thompson*, 5 N. Y. 320; *Leggett v. New Jersey Mfg. & Banking Co.*, 1 N. J. Eq. 541, 23 Am. Dec. 728; *Beach v. Palisade Realty & Amusement Co.*, 86 N. J. L. 238, 90 Atl. 1118; *Gorder v. Plattsmouth Canning Co.*, 36 Neb.

548, 54 N. W. 830; *Yanish v. Pioneer Fuel Co.*, 64 Minn. 175, 66 N. W. 198; *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454.

¹⁰⁹ *Royal Bank of Liverpool v. Grand Junction Railroad & Depot Co.*, 100 Mass. 444, 97 Am. Dec. 115.

¹¹⁰ *Cannon v. Gorham*, 136 Ga. 167, 71 S. E. 142, Ann. Cas. 1912C 39, 42n; *Danville Seminary v. Mott*, 136 Ill. 289. And see *Tenney v. East Warren Lumber Co.*, 43 N. H. 343; *Johnston v. Crawley*, 25 Ga. 316; *Ransom v. Stonington Sav. Bank*, 13 N. J. Eq. 212; *Stebbins v. Merritt*, 10 Cush. (Mass.) 27; *St. Philip's Church v. Zion Presbyterian Church*, 23 S. C. 297.

And it has been held that, although a corporation may have adopted a particular seal, a deed sealed with any other seal, if it is adopted by the corporation for the occasion, is valid. *Tenney v. East Warren Lumber Co.*, 43 N. H. 343.

tory, contracts made by other officers, or by less than the prescribed number, will not be binding.¹¹¹ Where the charter of a corporation provided that, before certain contracts should be made by the corporation, the consent of the stockholders, or a certain proportion of them, should be obtained, or that notice should be given them, it was held that the provision was intended merely for their protection, and might be waived by them, and that it did not affect the powers of the corporation.¹¹² It has also been held that such a provision does not apply to contracts which are within the powers of a corporation, and which have been executed by the other party, so that the corporation has received the consideration.¹¹³

V. POWER TO TAKE AND HOLD STOCK.

§ 65. Power to take and hold stock in another corporation.—A corporation has no power to subscribe for or purchase shares of stock in another corporation, unless such power is expressly granted, or unless the nature of the corporation and the purpose for which the stock is acquired are such as to render the transaction a necessary or reasonable means of carrying out the object for which it was created.

In England it seems to be settled that a corporation, unless expressly prohibited, has the power to purchase and hold shares of stock in other corporations, impliedly and without express provision. It has been so held, for example, in the case of ordinary banking and trading companies.¹¹⁴ But railway and other semi-public corporations cannot, without statutory authority, deal in the shares of other companies.¹¹⁵

In the United States there are some cases to the same effect,¹¹⁶ but they are opposed to the decided weight of authority both in

¹¹¹ *Homersham v. Wolverhampton Waterworks Co.*, 6 Exch. 137; *Couch v. City Fire Ins. Co.*, 38 Conn. 181, 9 Am. Rep. 375.

¹¹² *Nelson v. Hubbard*, 96 Ala. 238, 11 So. 428, 17 A. L. R. 375; *Beecher v. Marquette & Pac. Rolling Mill Co.*, 45 Mich. 103, 7 N. W. 695.

¹¹³ *Pixley v. Western Pac. R. Co.*, 33 Cal. 183, 91 Am. Dec. 623. See also, *Curtis v. Piedmont Lumber & Mining Co.*, 109 N. C. 403, 13 S. E. 944; *Clowe v. Imperial Pine Product Co.*, 114 N. C. 304, 19 S. E. 153.

¹¹⁴ *In re Asiatic Banking Corp.*,

4 Ch. App. 252; *In re Barned's Banking Co.*, 3 Ch. App. 105; *In re William Thomas & Co.*, [1915] 1 Ch. 325.

¹¹⁵ *Brice, Ultra Vires* (3rd Ed.) 633.

¹¹⁶ *Booth v. Robinson*, 55 Md. 419 (a steamship company having money to loan may invest it in the stock of other corporations in good faith); *White v. G. W. Marquardt & Sons*, 105 Iowa 145, 74 N. W. 930; *State ex inf. Hadley v. Missouri Pac. R. Co.*, 237 Mo. 338, 141 S. W. 643 (a railroad company may acquire stock in coal and elevator companies for

the federal and state courts. The prevailing doctrine is that a corporation has no power either to subscribe for or purchase shares of stock in another corporation, unless such power is expressly conferred upon it by its charter, or by implication as a necessary or reasonable means of accomplishing the objects for which it was created.¹¹⁷ It would seem to be wise to give a corporation express power to hold stock in other corporations and not trust to the implication of such power where it may be incidental to the general objects.¹¹⁸

The denial of implied power is based upon the ground that such a transaction is risking the corporate funds in an enterprise foreign to the objects of its creation. A corporation, therefore, may take and hold stock in another corporation whenever it is expressly authorized to do so. And it may do so without express authority, as incidental to its business, whenever the circumstances are such as to render the transaction a necessary or proper means of accomplishing the objects of its creation. "Whether the purchase of stock in one corporation by another is *ultra vires* or not must depend upon the purpose for which the purchase was made, and whether such purchase was, under all the circumstances, a necessary or reasonable means of carrying out the object for which the corporation was created, or one which under the statute it might accomplish."¹¹⁹

the purpose of facilitating the business for which it was chartered). See 36 Am. St. Rep. 141n; 18 L. R. A. 252n.

¹¹⁷ *Golden v. Cervenka*, 278 Ill. 409, 116 N. E. 273; *First Nat. Bank of Charlotte v. National Exch. Bank of Baltimore*, 92 U. S. 122, 23 L. Ed. 679; *California Bank v. Kennedy*, 167 U. S. 362, 42 L. Ed. 198, 17 Sup. Ct. 831; *Franklin Co. v. Lewiston Institution for Savings*, 68 Me. 43, 28 Am. Rep. 9; *Hyams v. Old Dominion Co.*, 113 Me. 294, 93 Atl. 747, L. R. A. 1915A 1128; *Nassau Bank v. Jones*, 95 N. Y. 115, 47 Am. Rep. 14; *Franklin Bank of Cincinnati v. Commercial Bank of Cincinnati*, 36 Ohio St. 350, 355, 38 Am. Rep. 594; *Valley Ry. Co. v. Lake Erie Iron Co.*, 46 Ohio St. 44, 18 N. E. 486, 1 L. R. A. 412; *Buckeye Marble & Freestone Co. v. Harvey*, 92 Tenn. 115, 20 S. W. 427, 18 L. R. A. 252, 36 Am. St. Rep. 71; *People*

ex rel. Peabody v. Chicago Gas Trust Co., 130 Ill. 268, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319; *Denny Hotel Co. of Seattle v. Schram*, 6 Wash. 134, 32 Pac. 1002, 36 Am. St. Rep. 130, 137; *Elkins v. Camden & A. R. Co.*, 36 N. J. Eq. 5; *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787, 31 L. R. A. 415.

When a corporation has no power to subscribe for or purchase stock in another corporation, it cannot do so indirectly through a trustee or agent. *Central Ry. Co. v. Pennsylvania R. Co.*, 31 N. J. Eq. 475; *Nassau Bank v. Jones*, 95 N. Y. 115, 47 Am. Rep. 14.

¹¹⁸ See *Market St. Ry. Co. v. Hellman*, 109 Cal. 571, 590, 42 Pac. 225, 231; *Venner v. Southern Pac. Co.*, 279 Fed. 832; *Central Life Securities Co. v. Smith*, 236 Fed. 170.

¹¹⁹ *Hill v. Nisbet*, 100 Ind. 341, 349; 32 Yale Law Journal 286n; *Farmers' State Bank v. Richter*, 48

In *Farmers State Bank v. Richter*,¹²⁰ it was held that where the subscription for stock in an electric company by the cashier of the bank at the instance of the directors was for the purpose of enabling the bank to procure electric light in the bank, that it was a question of fact whether it was a reasonable means to enable the bank to carry on its business more easily or comfortably, and was not a violation of a statute prohibiting banks from investing their assets in the stock of other corporations. The power to subscribe has however, been distinguished from the power to purchase or invest. Some authorities hold that a corporation cannot become an original subscriber for stock in another corporation, and even express power to acquire stock it is said gives no power to subscribe for new stock, but only to purchase issued stock.¹²¹ But generally it is held that a corporation has incidental power to take stock when this appears a proper means of accomplishing its legitimate objects and it may even organize subsidiary corporations. Thus it has been held that a railroad company could operate a coal mine or a grain elevator for the needs of its business, and it may do so indirectly by owning a majority of the shares of other corporations to assist in conducting the business for which it was chartered.¹²²

A corporation may have implied power to invest surplus funds, not needed for the time in its business, in dividend-paying stocks of established concerns. Power to invest in bonds could be more readily implied as stock transactions easily tend toward speculation. But even express power to acquire, hold and dispose of stocks of other corporations does not authorize a corporation to

N. D. 1233, 189 N. W. 242 (subscription by bank to stock of a lighting company to obtain light for bank.

But see *People ex rel. Fitz-Henry v. Union Gas. & Electric Co.*, 254 Ill. 395, 98 N. E. 768, Ann. Cas. 1916 B 201.

¹²⁰ 48 N. D. 1233, 189 N. W. 242. See *Fourth Nat. Bank of Nashville v. Stahlman*, 132 Tenn. 367, 178 S. W. 942, L. R. A. 1916A 568, 584n. A banking corporation cannot, as a rule, purchase the stock of other corporations as a speculation or investment, but it may loan money thereon and acquire the stock in collecting the debt or in compromising a doubtful claim. A bank may according to the Tennessee court sub-

scribe for stock in a corporation organized to erect a building, part of which is to be rented to the bank as a place of business.

¹²¹ *Robotham v. Prudential Ins. Co. of America*, 64 N. J. Eq. 673, 53 Atl. 842. Compare *Kardo Co. v. Adams*, 231 Fed. 950, 965, overruling *American Ball Bearing Co. v. Adams*, 222 Fed. 967.

¹²² *State ex inf. Hadley v. Missouri Pac. Ry. Co.*, 237 Mo. 338, 141 S. W. 643. See *Fourth Nat. Bank of Nashville v. Stahlman*, 132 Tenn. 367, 178 S. W. 942, L. R. A. 1916A 568; *Edwards v. International Pavement Co.*, 227 Mass. 206, 116 N. E. 266.

reorganize a subsidiary corporation into a holding corporation for itself.¹²³

In some states there is a public policy or an implied prohibition against one corporation holding stock in other corporations, and such power cannot be given even by express provision. In others there are statutory prohibitions or restrictions.¹²⁴

The implied power to acquire stock in other corporations turns on the reason for the transaction, whether for investment of surplus funds, as collateral security for a loan, in payment of a debt, by way of compromise, to control or prevent competition, or to provide needed facilities for the authorized business. It has repeatedly been held in effect, both in England and in the federal and state courts in this country, that, whenever a corporation has the power to lend money or enter into any other contract, it has the power, unless prohibited by its charter or some other statute, to take a pledge of stock in another corporation to secure payment of the loan or performance of the contract.¹²⁵ A corporation certainly

¹²³ Robinson v. Holbrook, 148 Fed. 107. Express power to purchase, hold and dispose of shares in other corporations in the charter of a company organized for the purpose of manufacturing goods made of gold, silver or other metals, is held to be an incidental power to invest, and does not include power to initiate or promote other distinct enterprises, or to reorganize a subsidiary company into a holding corporation to control the parent company. See also, Schwab v. E. G. Potter Co., 194 N. Y. 409, 87 N. E. 670; 7 Columbia Law Rev. 211.

In Schwab v. E. G. Potter Co., 194 N. Y. 409, 87 N. E. 670, aff'g 129 N. Y. App. Div. 36, 113 N. Y. Supp. 439, it is held that a corporation cannot create a new corporation and convey to such new corporation a part of the old company's assets, receiving in return all the stock of the new company, which the stockholders of the old corporation are required to subscribe for or lose their interests in the assets so conveyed. Such transaction is not authorized by the provision of the New York stock corporation law, providing that a stock corporation, if permitted by its charter, may acquire, hold, and dispose of stock issued by another corporation.

¹²⁴ Franklin Bank v. Commercial Bank, 36 Ohio St. 350, 38 Am. Rep. 594; Converse v. Emerson Talcott & Co., 242 Ill. 619, 90 N. E. 269; People ex rel. Peabody v. Chicago Gas Trust Co., 130 Ill. 268, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319. The laws of Illinois do not permit except for limited purposes the holding of stock by one corporation in another. The purchase of stock in other companies by a gas company is impliedly prohibited and cannot be made one of the objects by the articles. See also, Central Life Securities Co. v. Smith, 236 Fed. 170.

Subscribing for stock in the organization of another corporation by a manufacturing corporation is *ultra vires* and void, and the corporation is not estopped to set up *ultra vires* to the suit of the receiver of the new corporation for the unpaid balance on the stock, even though it had received the stock and held it for more than 20 years. Converse v. Emerson, Talcott & Co., 242 Ill. 619, 90 N. E. 269. See note by C. G. Little, 4 Illinois Law Rev. 581.

¹²⁵ In re Asiatic Banking Corp., 4 Ch. App. 252; Citizens' State Bank of Noblesville v. Hawkins, 71 Fed. 369; Germania Nat. Bank of New

has the power to take stock in another corporation in good faith in payment of a debt, in order to collect the debt and prevent a loss.¹²⁶

Taking stock to effect compromise.—A corporation may also take stock in another corporation in good faith in order to effect a compromise of a contested claim against it. Thus, it has been held by the U. S. Supreme Court that a national bank, though it has no power to deal in the stock of other corporations, may, in a fair and *bona fide* compromise of a contested claim against it growing out of a legitimate banking transaction, pay a larger sum than would have been exacted in satisfaction of the demand, so as to obtain by the arrangement a transfer of certain stocks in railroad and other corporations; it being honestly believed at the time that, by turning the stocks into money under more favorable circumstances than then existed, a loss which would otherwise accrue from the transaction might be averted or diminished.¹²⁷ A question may be raised, however, whether there is not a distinction between taking stock in payment of a debt owing to the bank, which may be all that the debtor has, and paying \$55,000 on a contested claim against the bank on a certificate of deposit, which could be settled for \$20,000, in order to acquire stock in coal mines and railroads. This looks like putting \$35,000 into speculation, unless the stocks can be sold at once for more than this amount.

Taking stock in payment on sale of corporate property.—It has been held that a manufacturing company, or other purely private corporation which owes no special duties to the public, may, in the absence of express prohibition, sell all of its property to another corporation, and take stock in the other corporation in payment therefor, provided all the stockholders consent, and pro-

Orleans v. Case, 99 U. S. 628, 633, 25 L. Ed. 448; Kennedy v. California Sav. Bank, 101 Cal. 495, 35 Pac. 1039, 40 Am. St. Rep. 69; California Bank v. Kennedy, 167 U. S. 362, 42 L. Ed. 198, 17 Sup. Ct. 831.

¹²⁶ First Nat. Bank of Charlotte v. National Exch. Bank of Baltimore, 92 U. S. 122, 23 L. Ed. 679; Citizens' State Bank of Noblesville v. Hawkins, 71 Fed. 369; Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co., 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448.

¹²⁷ First Nat. Bank of Charlotte v. National Exch. Bank of Balti-

more, 92 U. S. 122, 23 L. Ed. 679, aff'g 39 Md. 600. See note L. R. A. 1916A 584, on power of a national bank to acquire and hold stock in other corporations.

A national bank cannot become owner in satisfaction of a debt, of shares represented by transferable certificates of a partnership because this means that the transferee becomes a member of the firm, and goes into its business with unlimited personal liability. Merchants' Nat. Bank of Cincinnati v. Wehrmann, 202 U. S. 295, 300, 50 L. Ed. 1036, 1040, 26 Sup. Ct. 613.

vided the transaction is for the *bona fide* purpose of winding up the corporation and distributing the stock among the stockholders.¹²⁸ If the business is unsuccessful and there is no reasonable prospect of being able profitably to resume the business for which it was incorporated the majority of the stockholders may realize in the only way possible, by a sale of the property. In general, the sale should be for money, but an exception is recognized in favor of a sale for stock which has an established market value equivalent to money.

Purchase of stock to control corporation, and speculation in stock.—The general rule that a corporation cannot purchase and hold stock in another corporation is peculiarly applicable where the object in doing so is to obtain control of the business of the other corporation and remove competition. In such a case the purchase and holding of the stock is contrary to public policy and illegal, as well as *ultra vires*.¹²⁹ And even though a corporation may have the power to take and hold shares of stock in other corporations as an investment, or as collateral security for a loan or other debt, or in payment of a debt, it has no power to go upon the stock exchange and buy shares as a speculation.¹³⁰

§ 66. Power of a corporation to acquire its own stock.—In England, and in some of the states in this country, it is held that an express grant of authority is necessary to enable a cor-

¹²⁸ *Geddes v. Anaconda Copper Min. Co.*, 254 U. S. 590, 65 L. Ed. 425, 41 Sup. Ct. 209; *Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co.*, 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448. And see *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.) 393, 66 Am. Dec. 490; *Leathers v. Janney*, 41 La. Ann. 1120, 6 So. 884, 6 L. R. A. 661; *Bowditch v. Jackson Co.*, 76 N. H. 351, 82 Atl. 1014, L. R. A. 1917A 1174, Ann. Cas. 1913A 366. See also, 30 Yale Law Journal 633n, on power of majority stockholders to sell entire property for stock.

¹²⁹ *Central Ry. Co. v. Collins*, 40 Ga. 582; *Elkins v. Camden & A. R. Co.*, 36 N. J. Eq. 5; *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319; *Pearson v. Concord R. Co.*, 62 N. H. 537, 13 Am. St. Rep. 590, *De La Vergne Refrigerating Mach. Co. v. German*

Sav. Inst., 175 U. S. 40, 20 Sup. Ct. 20, 44 L. Ed. 65; *Mallory v. Hanaur Oil-Works*, 86 Tenn. 598, 8 S. W. 396; *People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843; *Robotham v. Prudential Ins. Co. of America*, 64 N. J. Eq. 673, 53 Atl. 842, 13 Yale Law Journal 119. Compare *Venner v. New York Cent. & H. R. R. Co.*, 160 N. Y. App. Div. 127, 145 N. Y. Supp. 725; *Mannington v. Hocking Valley Ry. Co.*, 183 Fed. 133, 152.

¹³⁰ *In re Asiatic Banking Corp.*, 4 Ch. App. 252, per Giffard, L. J.; *Gause v. Commonwealth Trust Co.*, 196 N. Y. 134, 89 N. E. 476, 24 L. R. A. (N. S.) 967. The authority of a trust company to buy and sell stocks and bonds does not authorize it to indulge in hazardous promoting schemes in the hope of large commissions, e. g. to guarantee the sale of securities by a stranger.

poration to purchase shares of its own stock, either for the purpose of reissuing or retiring them; but in most states such power exists without an express grant of authority, provided there is no express restriction, and provided the purchase is made from surplus and without prejudice or injury to creditors. A corporation may in all states take its own stock as collateral for or in payment of debts previously contracted in good faith, in order to prevent loss, or in order to effect a compromise.

In England, though a corporation may deal in the shares of other corporations, it is held that it cannot purchase shares of its own stock, even though such power purporting to authorize the purchase be found in the articles, whether its purpose be to reissue them or to retire them.¹³¹ If the corporation buys stock in another corporation the contribution represented by the stock is still invested in that corporation's business. This is an asset of possible value to creditors. But if the corporation "invests" in its own stock, the capital contribution represented by the stock is simply withdrawn from the business and nothing takes its place in the treasury, unless the stock is reissued for value received. In the leading English case of *Trevor v. Whitworth*,¹³² the shareholder was claiming against the company in liquidation for the balance of the price of shares. The purchase was made in pursuance of a scheme to keep it a closed or family company, by which the directors acquired over one-fourth of the outstanding shares prior to the date of liquidation. It was held not incidental to the objects of the corporation as a manufacturer of flannel so to expend the funds of the company. It did not appear that the company had any surplus at the time the price became due. "There is a great difference," it was said, "between dealing in the shares of other companies and in its own. The former is ordinary business, attended only with the usual risks of ordinary transactions, but the

¹³¹ *Trevor v. Whitworth*, 12 App. Cas. 409. The company purchased more than 4,000 out of its total issue of 15,000 shares. Held, *ultra vires*, "Persons who deal with and give credit to, a limited company, naturally rely on the fact that the company is trading with a certain amount of capital; . . . and they are entitled to assume that no part of the capital . . . has been subsequently paid out except in the legitimate course of its business."

See *In re Dronfield Silkstone Coal Co.*, 17 Ch. Div. 76; *Billerby v. Rowland, etc., SS. Co.*, [1902] 2 Ch. 14.

¹³² 12 App. Cas. 409. May a case ever occur where the purchase of its own shares is incidental to the legitimate business objects of a corporation? Yes, to obtain satisfaction of a debt or claim, to remove an obstructive member, or possibly to increase the dividends to be derived by the remaining members.

latter tends inevitably to breaches of their duty on the part of the directors, and to fraud and rigging the market on the part of the corporation itself. Consequently, a corporation, to possess such a power, must have it conferred by the plainest and most explicit language." 133

The question is not merely one of implication of a power to purchase but of the safeguarding of creditors, sometimes described as the "trust fund" doctrine. If one-fourth of the paid up capital of the company may be thus withdrawn, why may not all the shareholders surrender and claim repayment of the sums paid in upon their shares as against the creditors?

Conflicting rules in United States.—In the United States the decisions on this question are conflicting. Some of the courts have held, as in England, that a corporation cannot purchase its own shares of stock, either to retire them or to reissue them, unless such power is expressly conferred by its charter or some statute.¹³⁴ This view is based, not only upon the ground that it is foreign to the purposes for which the corporation was created, and therefore not within its implied powers, but also on the ground that the capital contributed is a trust fund for the security of existing and future creditors, which cannot be withdrawn or reduced except by amendment of the charter or other procedure prescribed by law. It may be prejudicial to stockholders and also to creditors.¹³⁵ A

¹³³ *Trevor v. Whitworth*, 12 App. Cas. 409. The case of *In re Dronfield S. Co.*, 17 Ch. Div. 76, was distinguished. There is a difference where the transaction is executed during solvency of the company. It may not be possible to rescind an executed transaction and restore the parties to their original position. In *Trevor v. Whitworth* the applicants were seeking to enforce against the company's assets a contract of sale, and the stockholders were in competition with the creditors for payment out of the capital as to which the creditors have the prior claim.

¹³⁴ *Crandall v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560; *Currier v. Lebanon Slate Co.*, 56 N. H. 262; *Coppin v. Greenlees & Ransom Co.*, 38 Ohio St. 275, 43 Am. Rep. 425; *Morgan v. Lewis*, 46 Ohio St. 1, 17 N. E. 558; *State v. Oberlin Building & Loan Ass'n*, 35 Ohio St. 258; *Maryland Trust Co. v. National Me-*

chanics' Bank, 102 Md. 608, 623, 63 Atl. 70; *Darnell-Love Lumber Co. v. Wiggs*, 144 Tenn. 113, 230 S. W. 391. See 10 *Cornell Law Quarterly* 371.

¹³⁵ See *In re Tichenor-Grand Co.*, 203 Fed. 720; *Trevor v. Whitworth*, 12 App. Cas. 409; *Coppin v. Greenlees & Ransom Co.*, 38 Ohio St. 275, 43 Am. Rep. 425; *Morgan v. Lewis*, 46 Ohio St. 1; *Fitzpatrick v. McGregor*, 133 Ga. 332, 65 S. E. 859, 25 L. R. A. (N. S.) 50 and note; *Kelly v. Central Union Fire Ins. Co.*, 101 Kan. 91, 165 Pac. 806, L. R. A. 1918C 1170; *Darnell-Love Lumber Co. v. Wiggs*, 144 Tenn. 113, 230 S. W. 391; *Kom v. Cody Detective Agency*, 76 Wash. 540, 136 Pac. 1155, 50 L. R. A. (N. S.) 1073 (corporation cannot purchase its own stock); *Lefker v. Harner*, 123 Ark. 575, 186 S. W. 75, L. R. A. 1916F 281 (a trust company may not purchase for retirement so much of its own stock

purchase of its own shares by a corporation is none the less *ultra vires* and fraudulent as to creditors because made with the consent of all the stockholders. The rule cannot be evaded by purchasing and holding the stock through an agent or trustee.¹³⁶

It is argued in the English cases that if the corporation purchases its shares with the intention of reissuing them this would amount to speculation in the shares, and would be unauthorized. If the corporation does not intend to resell them, this would be an indirect and improper method of reducing the capital of the company. A transfer of capital to a stockholder for a surrender of his stock has the same effect upon creditors as the payment of a dividend from capital. It leaves in the corporate treasury a piece of paper in the place of valuable assets. Even a solvent corporation may not pay dividends out of capital. Moreover it is pointed out that the purchase increases the relative strength of the large holders and may even convert them into a majority.¹³⁷

Majority rule.—In most of the states the doctrine that a corporation cannot purchase and hold its own stock, unless expressly authorized to do so, is not recognized. On the contrary, most of the courts in which the question has arisen have held that it may do so without express authority, in the absence of express restrictions, provided it makes the payment from surplus and without prejudice to the rights of creditors.¹³⁸ Private corporations,

as to reduce its capital below the amount required by law). See Timlin, J., dissenting, in *Gilechrist v. Highfield*, 140 Wis. 476, 123 N. W. 102, 17 Ann. Cas. 1257, 1261 note, on right of a corporation to acquire its own stock.

¹³⁶ *Trevor v. Whitworth*, 12 App. Cas. 409; *Crandall v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560; *Lemoore Canal & Irrigation Co. v. McKenna*, 163 Cal. 736, 127 Pac. 345. A corporation may receive its stock as a gift if no liability is released in so doing. *Hasson v. Koeberle*, 180 Cal. 359, 181 Pac. 387; *Shaw v. Carr*, 93 Wash. 550, 161 Pac. 345 (surrender of stock to corporation to be sold to obtain working capital).

¹³⁷ *Machen, Corporations*, sec. 626. The reasons urged against the power to purchase its own stock are: (1) That it takes away the basis of financial responsibility upon which creditors have a right to rely. This is some-

times described by saying that the capital stock is a "trust fund" which cannot be withdrawn by stockholders. (2) Such purchase strengthens the relative position of the majority stockholders as against the minority. (3) A reduction of the capital stock should be by amendment of the articles duly recorded. 2 Minn. L. Rev. 456.

¹³⁸ *Keith v. Kilmer*, 261 Fed. 733, 9 A. L. R. 1287; *New England Trust Co. v. Abbott*, 162 Mass. 148, 38 N. E. 432, 27 L. R. A. 271; *Dupee v. Boston Water Power Co.*, 114 Mass. 37 (the corporation was solvent and in liquidation so there was no danger of harm to future creditors. 34 Harv. Law Rev. 295); *Dock v. Schlichter Jute Cordage Co.*, 167 Pa. St. 370, 131 Atl. 656; *Atlanta & Walworth Butter & Cheese Ass'n v. Smith*, 141 Wis. 377, 123 N. W. 106, 32 L. R. A. (N. S.) 137, 135 Am. St. Rep. 42; *Turner v. Goetz*, 184 Wis.

said the Illinois court, "may purchase their stock in exchange for money or other property, and hold, reissue or retire the same, provided such act is had in entire good faith, is an exchange of equal value, and is free from all fraud, actual or constructive, this implying that the corporation is neither insolvent nor in process of dissolution," and provided "the rights of creditors are not affected." ¹³⁹

Express restriction.—Sometimes the charter of a corporation or the general law under which it is organized expressly prohibits it from purchasing its own stock. Thus, the national bank act expressly prohibits a national bank from purchasing or holding shares of its own capital stock except when it is necessary to prevent loss on a debt previously contracted in good faith.¹⁴⁰ Similar statutes exist in some states as to state banks and in a few as to other corporations.

Fraud or prejudice to stockholders or creditors.—Even in those jurisdictions in which it is held that a corporation may purchase its own stock, the rule is subject to the condition that the purchase shall be made in good faith and without prejudice to the rights of other stockholders or creditors. It is unauthorized and invalid if made for the purpose of defrauding or injuring other stockholders or creditors of the corporation,¹⁴¹ or if it does in fact defraud or

508, 199 N. W. 155 (power of Delaware corporation is determined by laws of Delaware).

A corporation has power to purchase the shares of its own capital stock when such purchase is made for a legitimate and honest purpose and the rights of creditors do not suffer thereby. *Gilchrist v. Highfield*, 140 Wis. 476, 123 N. W. 102, 17 Ann. Cas. 1257. See *Wormser*, the power of a corporation to acquire its own stock, 24 *Yale Law Journal* 177, 188; note 27 *Harv. Law Rev.* 747; 34 *Harv. L. Rev.* 293; 13 *Columbia Law Rev.* 148.

¹³⁹ *Clapp v. Peterson*, 104 Ill. 26; *Fraser v. Ritchie*, 8 Ill. App. 554. In this last case the company continued doing a prosperous business for over a year after the stockholders sold their stock and retired from the company. At the time of the purchase the company had assets sufficient to pay all its liabilities, including the outstanding stock, leaving a large surplus. *Acc. Ken-*

nerly v. Columbia Chemical Corp., 137 Va. 240, 119 S. E. 265; *San Antonio Hardware Co. v. Sanger* (Tex.), 151 S. W. 1104.

¹⁴⁰ Rev. St. U. S. § 5201. See *First Nat. Bank of Xenia v. Stewart*, 107 U. S. 676, 27 L. Ed. 592, 2 Sup. Ct. 778; *Wallace v. Hood*, 89 Fed. 11; *Lantry v. Wallace*, 182 U. S. 536, 551, 45 L. Ed. 1218, 1225, 21 Sup. Ct. 878. Where national bank purchases its own stock and sells it, the sale is voidable, not void, and the vendee becomes liable as a stockholder. *Schulte v. Boulevard Gardens Land Co.*, 164 Cal. 464, 129 Pac. 582, 44 L. R. A. (N. S.) 156, Ann. Cas. 1914B 1013. The prohibition of reducing the capital stock, refers not to the outstanding shares, the certificates of membership, but to the actual capital, i. e., the assets, with which the corporation carries on its business.

¹⁴¹ *In re S. P. Smith Lumber Co.*, 132 Fed. 618; *Chicago, P. & S. W. R. Co. v. Town of Marseilles*, 84 Ill.

prejudice creditors or other stockholders, though made in the most perfect good faith.¹⁴²

The basis of the financial responsibility of the company is the fund contributed by the subscribers to the common venture. If all the stockholders "sold" their shares to the company in the end the corporation would vanish into nothing and only the cancelled stock certificates would remain in the empty treasury to attest the former existence of the corporation.¹⁴³ If a stockholder sells or surrenders his stock to the corporation in exchange for corporate assets, knowing that the result will be to render the corporation insolvent, the transfer is fraudulent and invalid as against existing creditors. If it is intended that the corporation shall continue in business and incur indebtedness, the creditors relying on the appearance of its previous solvent condition continuing, the stockholder will be estopped to claim that his relations to the corporation were severed by the transaction, and the transaction will be void as to subsequent creditors.¹⁴⁴ It is the general doctrine that subsequent creditors cannot be regarded as prejudiced by any such purchase unless the purchase was made in anticipation of possible future insolvency or the remaining property was of insufficient value to afford ample resources for the debts of the corporation.¹⁴⁵

The time at which the corporation that purchases its own stock must have surplus earnings or accumulated profits over and above its capital stock is at the time the corporation is called upon to pay

145, 643; *Clapp v. Peterson*, 104 Ill. 26; *Commercial Nat. Bank v. Burch*, 141 Ill. 519, 31 N. E. 420, 33 Am. St. Rep. 331; *Columbian Bank's Estate*, 147 Pa. St. 422, 23 Atl. 625, 626, 628; *Marshall Foundry Co. v. Killian*, 99 N. C. 501, 6 S. E. 680, 6 Am. St. Rep. 539. Some courts hold that there is no fraud if the remaining corporate property at the time of the transfer is ample to meet the debts of the corporation. *Singhaus v. Piper*, 103 Neb. 493, 172 N. W. 523. Insolvency at some later time is immaterial. *Copper Belle Min. Co. v. Costello*, 12 Ariz. 105, 95 Pac. 803.

¹⁴² *Commercial Nat. Bank v. Burch*, 141 Ill. 519, 31 N. E. 420, 33 Am. St. Rep. 331; *Clapp v. Peterson*, 104 Ill. 26; *Price v. Pine Mountain Iron & Coal Co.*, 17 Ky. L. Rep. 865, 32 S. W. 267. Under the Delaware statute a corporation may use only the surplus for purchase of its

own shares, but in Wisconsin a corporation may purchase provided it is done in good faith and creditors are not in fact injured. *Turner v. Goetz*, 184 Wis. 508, 199 N. W. 155. The Delaware statute governs a Delaware corporation in Wisconsin.

¹⁴³ *Morawetz, Corporations*, sec. 113. See *Pierce v. United States*, 255 U. S. 398, 65 L. Ed. 697, 41 Sup. Ct. 365, per Brandeis, J.: "The law which sends a corporation into the world with the capacity to act imposes upon its assets liability for its acts. The corporation cannot disable itself from responding by distributing its property among its stockholders and leaving remediless those having valid claims."

¹⁴⁴ *Atlanta & Walworth Butter & Cheese Ass'n v. Smith*, 141 Wis. 377, 123 N. W. 106, 32 L. R. A. (N. S.) 137, 135 Am. St. Rep. 42.

¹⁴⁵ *Singhaus v. Piper*, 103 Neb. 493, 172 N. W. 523.

for the stock. The capital stock takes the place of individual liability. In the case of *Re Fechheimer Fishel Co.*,¹⁴⁶ the court held that the note of a New York corporation, given in payment of its own stock, was unenforceable as against creditors if the corporation was insolvent at the time of maturity, although the note was given in good faith and at a time when the company was solvent. In effect such a note is but a promise to pay out of surplus profits if they exist.¹⁴⁷ Corporations sometimes sell stock or procure subscriptions with a contract to repurchase or take back the stock after a certain time, if the holder so desires. Such an agreement is valid but cannot be enforced to the prejudice of creditors, as where its liabilities exceed its assets at the time for performance.¹⁴⁸

Taking stock in payment of debts, or to effect compromise.—

In the absence of express restrictions, even in those states in which power on the part of a corporation to purchase shares of its own stock is denied, a corporation has the power, in order to prevent

¹⁴⁶ In *re Fechheimer-Fishel Co.*, 212 Fed. 357. In *re O'Gara & McGuire*, 259 Fed. 935, it is said: "The decision in that case is sound in principle. The capital stock of a corporation is a trust fund for the payment of creditors. It takes the place of individual liability in firm and individual transactions. Faith that the capital stock will not be impaired is the basis of the extension of corporate credit and an inspiration to commercial transactions. Creditors have the right to look to this fund as sacred and inviolable, and to assume that it will be preserved for their protection. Unless it be held that a contract by a corporation for the purchase of its capital stock cannot be enforced, except out of surplus earnings or accumulated profits, the security of creditors is gone, and a door for fraud is opened. A stockholder, who sells his stock to the company that issued it, without receiving cash therefor out of surplus earnings and accumulated profits, must take the responsibility and assume the risk that payment at some future day will not impair the capital stock. This responsibility is not affected by the solvency of the corpo-

ration at the time the contract was made or the good faith of its officers in the execution thereof."

¹⁴⁷ *Keith v. Kilmer*, 261 Fed. 733, 9 A. L. R. 1287, 1296, note on claim of one selling to corporation its own stock as provable against its estate in bankruptcy.

¹⁴⁸ *Schulte v. Boulevard Gardens Land Co.*, 164 Cal. 464, 129 Pac. 582, 44 L. R. A. (N. S.) 156; *Ann. Cas.* 1914B 1013; *Booth v. Union Fibre Co.*, 142 Minn. 127, 171 N. W. 307; *Martin-Tire & Rubber Co. v. Kelley Tire & Rubber Co.*, 101 Conn. 534, 126 Atl. 697. A contract by a corporation to buy its own stock from a stockholder in case it cannot satisfactorily carry out its corporate purposes is invalid as against other stockholders and creditors; noted in 10 *Cornell Law Quarterly* 371; *Hoover Steel Ball Co. v. Schaefer Ball Bearings Co.*, 90 N. J. Eq. 164, 106 Atl. 471. A contract by a corporation to repurchase its stock at the option of the purchaser is unenforceable against the corporation, if it becomes insolvent. In *re Tichenor-Grand Co.*, 203 Fed. 720 (purchase should leave original capital intact, i. e., payment should be from surplus).

loss, to take its own shares in payment of a debt previously contracted in good faith.¹⁴⁹ The National Bank Act expressly gives such power to national banks, though it prohibits them from otherwise purchasing their own shares; but it requires them to sell shares so acquired, at public or private sale, within six months after taking the same.¹⁵⁰ A corporation may also take shares of its own stock, in the absence of express restriction, even in those jurisdictions in which it is held that it cannot purchase its own stock, in order to effect a compromise of a disputed claim against the holder, whether the claim arises out of the latter's subscription to its capital stock, or out of some other contract or transaction.¹⁵¹

The question remains, what is the effect of the lawful purchase of its own stock by a corporation? Is it thereby retired and cancelled, or is it to be treated as still issued and outstanding, so that it may be sold without subscription liability at less than par?

Treasury stock, alive but dormant.—It has been held that stock once issued remains outstanding until retired and cancelled. The stock when acquired by the corporation issuing it is not thereby extinguished or cancelled, but may be kept alive, though dormant. It may be sold by the corporation at its market value or may be issued as a stock dividend without liability to pay up its par value on the part of the holder. While held by the corporation it cannot be voted or draw dividends. It has been pointed out that it is a mere fiction to regard the new shares issued as if they were the old shares, and as if the corporation were merely an intermediate transferee, as a corporation cannot really hold shares in itself.¹⁵²

¹⁴⁹ *Ralston v. Bank of California*, 112 Cal. 208, 214, 44 Pac. 476; *Currier v. Lebanon Slate Co.*, 56 N. H. 262; *Coppin v. Greenlees & Ransom Co.*, 38 Ohio St. 275, 43 Am. Rep. 425; *Morgan v. Lewis*, 46 Ohio St. 1, 17 N. E. 558.

¹⁵⁰ See *Union Nat. Bank v. Hunt*, 76 Mo. 439. See also *Sigel v. Security State Bank of Warroad*, 134 Minn. 272, 159 N. W. 567.

¹⁵¹ *State v. Oberlin Building & Loan Ass'n*, 35 Ohio St. 258; *Morgan v. Lewis*, 46 Ohio St. 1, 17 N. E. 558.

¹⁵² *Morawetz*, Corporations, sec. 114. *Morawetz* arrays his opinion against that of the courts. In re

Borg v. International Silver Co., 11 Fed. (2d) 147, 150 it is said: "Indeed, the only difference between a share held in the treasury and one retired is that the first may be resold for what it will fetch on the market, while the second has disappeared altogether. *Enright v. Heckscher*, 240 Fed. 863, 874; *Rural Homestead Co. v. Wildes*, 54 N. J. Eq. 668, 35 Atl. 896; *Cook on Corporations*, § 286. They are not a present asset, because, as they stand, the defendant cannot collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations."

But the generally accepted view is that the shares are not retired by the mere fact of purchase by the corporation.¹⁵³

¹⁵³ *Borg v. International Silver Co.*, 11 Fed. (2d) 147; *Ralston v. Bank of California*, 112 Cal. 208, 44 Pac. 476; *Knickerbocker Importation Co. v. State Board of Assessors*, 74 N. J. Law 583, 65 Atl. 913, 9 L. R. A. (N. S.) 885; *San Antonio Hardware Co. v. Sanger (Tex.)*,

151 S. W. 1104, 1110; *Pabst v. Goodrich*, 133 Wis. 43, 113 N. W. 398, 14 Ann. Cas. 824; *Machen, Corporations*, sec. 633. But see *In re Sovereign Life Assur. Co.*, [1892] 3 Ch. 279; *Buckley, Company Acts* (10th Ed.), pp. 140, 141.

CHAPTER VII.

EFFECT OF ULTRA VIRES TRANSACTIONS.

I. IN GENERAL.

§ 67. Basis of the doctrine of *ultra vires*.—The defense of *ultra vires* is frequently not meritorious. It is supposed to protect:

- (1) The interest of the public that the corporation shall not usurp powers not granted.
- (2) The interest of the stockholders in confining their investment to the risks and enterprises authorized. The true function of the doctrine is to protect those who have a legitimate interest in confining the corporation to its specified purposes.

There is perhaps no part of the law concerning corporations in which we meet with so much difficulty, confusion, and conflict of opinion as in that which relates to the legal effect of *ultra vires* transactions. We have already considered at length the powers of corporations, and have seen that a corporation is authorized to do only those things which are expressly or impliedly incident to the corporate business.

We are now to ascertain, as well as the state of the law will permit, the effect of transactions, on behalf of a corporation, which are foreign to its authorized business. Such transactions are said to be *ultra vires*, or *extra vires*. Transactions which are within the powers of a corporation are said to be *intra vires*.

Unfortunately, the expression "*ultra vires*" has been used by the courts and by writers on corporation law in more than one sense, and this has resulted in some confusion.¹ It is especially

¹ See *Camden & A. R. Co. v. May's Landing & Egg Harbor City R. Co.*, 48 N. J. Law, 530, 7 Atl. 523; *Minnesota Thresher Mfg. Co. v. Langdon*, 44 Minn. 37, 41, 46 N. W. 310; *Bell v. Kirkland*, 102 Minn. 213, 218, 113 N. W. 271, 13 L. R. A. (N. S.) 793, 120 Am. St. Rep. 621; *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543,

579, 99 Am. Dec. 30; *Alabama Consol. Coal & Iron Co. v. Baltimore Trust Co.*, 197 Fed. 347. See Brice, *Ultra Vires* (3rd Ed.), pp. 44-49, Morawetz, *Corporations* (2nd Ed.), § 648.

For discussions of the *ultra vires* doctrine see 3 Page on Contracts (2nd Ed.), sec. 1994; 9 Harv. Law

unfortunate to include in the definition, as many courts and writers do, any theory as to the legal effect of the act, as to say that *ultra vires* signifies what is absolutely beyond the capacity of a corporation to transact. The definition should be made to turn upon the state of operative facts referred to, as foreign to the specified purposes or business of the corporation, or contrary to some restriction on the corporate activities. An *ultra vires* contract then is one contrary to restrictions, express or implied, imposed by the articles or agreement of association, by the charter or by statute. What the effect of violating the restriction may be and who is entitled to raise the question are questions on which the authorities differ. *Ultra vires* contracts may be such because (1) outside the scope and purpose and objects of the corporate enterprise, or (2) beyond certain limitations and restrictions, although within or incidental to the purposes contemplated.

The earlier English cases originating the doctrine of *ultra vires* were cases where the only parties concerned were stockholders and the corporation, holding that a minority could restrain the corporation from acting outside the purposes provided for.² In 1860 the doctrine was extended to relations with third parties. By this extension "it became possible for corporations to evade liability upon an irksome contract, by showing their incapacity originally to make the contract."³ Lord St. Leonards said:⁴ "In my opinion nothing can be more indecent than for a great company like this to allege, by way of defense, that a solemn contract which they have entered into is void on the ground of its not being within their powers, not from any mistake, misapprehension, or subsequent accident, but because they thought fit to enter into it, and meant to have the benefit of it, if it turned out for their benefit, and to take advantage of the illegality in case the contract should prove onerous and they should desire to get rid of it."

Rev. 255; 11 Harv. Law Rev. 387; 14 Harv. Law Rev. 332; 23 Harv. Law Rev. 495; 24 Harv. Law Rev. 534; 32 Harv. Law Rev. 281; 34 Harv. Law Rev. 292; 6 Cal. Law Rev. 319; 3 Ill. Law Rev. 445; 43 Am. Law Rev. 69, 81; 8 Yale Law Journal 24; 33 Yale Law Journal 49; 35 Yale Law Journal 13; 36 Yale Law Journal 297.

² Perhaps the earliest case on the doctrine of *ultra vires* dates only from 1846, Colman v. Eastern Coun-

ties Ry. Co., 16 L. J. (Ch.) 73; 10 Beav. 1; Carr, Corporations, pp. 65-67.

³ Carr, Corporations, p. 66.

⁴ Hawkes v. Eastern Counties Ry. Co., [1852] 1 De G. M. & G. 759, 42 Eng. Repr. 739; Eastern Counties Ry. Co. v. Hawkes, 5 H. L. Cas. 331, 349, 373 [1855] 10 Eng. Repr. 928, 934, quoted in Bath Gas Light Co. v. Claffy, 151 N. Y. 24, 45 N. E. 390, 392. See also, Shrewsbury R. Co. v. London Co., 16 Beav. 451, 51 Eng.

The doctrine of *ultra vires* as a defense to contracts is in a state of hopeless confusion and it is even urged that it should be entirely abandoned.⁵ The practical working of the rules has not been duly considered, and rules have been laid down without intelligible policy or principle. It is important therefore to bear in mind the true grounds and reasons for the doctrine and the interests which it is designed to protect. In *Olson v. Warroad Mercantile Co.*,⁶ it is said: "The doctrine of *ultra vires* is calculated to protect, *first*, the interest of the public that the corporation shall not transcend the powers granted to it, and *second*, the interest of the stockholders that the capital shall not be subjected to the risk of enterprises not contemplated by the articles of incorporation, and, therefore, not authorized by the stockholders in subscribing for the stock."

A conflict arises here between the interests of the stockholders and third persons who have dealt with the corporation. In some foreign systems of law it is provided that limitations or power cannot be set up against third persons, particularly against those acting in good faith. It is difficult to find a solution which reconciles the security of the stockholders with that of third persons, without requiring of them an impracticable examination into the probable interpretation of the charter powers.⁷ It becomes a question oftentimes upon whom the loss should fall as between innocent insiders and outsiders, when corporate officers have exceeded their authority under the charter. The strict doctrine of *ultra vires*, it has been well said, "gives the benefit to the corporation of the protection of the disabilities of a minor, or of a person *non compos mentis*, while it is well known that corporations are

Repr. 848. Defense not favored, but confined to narrow limits. Tryson v. Southern Realty Co., 274 Fed. 135.

⁵ C. E. Carpenter: Should the doctrine of *ultra vires* be discarded? 33 Yale Law Journal 49; Stevens, 36 Yale Law Journal, 297.

⁶ 136 Minn. 310, 314, 161 N. W. 713, citing Pittsburgh, C. & St. L. Ry. Co. v. Keokuk & H. Bridge Co., 131 U. S. 371, 33 L. Ed. 157, 9 Sup. Ct. 770; McCormick v. Market Nat. Bank of Chicago, 165 U. S. 538, 549, 41 L. Ed. 817, 821, 17 Sup. Ct. 433. Defense of *ultra vires* rests on regard for: (1) The interest of the public; (2) the interest of the stockholders, that the capital shall not be subjected to unauthorized risks; (3) the obligation of every-

one, entering into a contract with a corporation to take notice of the legal limits of its powers. This last is not a reason or basis for the defense, but merely a method of explaining a result.

⁷ Demogue, The impossibility of effecting contractual incompetence, 31 Yale Law Journal 626, 629.

Schuster, Principles German Civil Law, secs. 52, 58. The doctrine of *ultra vires* has no application in the case of any German trading corporation. No transaction entered into by one of the primary agents of a trading corporation is invalid on the ground that it is outside of the scope of the corporation's usual business or the objects for which it was created.

guided by the best of legal skill much more able to understand and interpret the provisions of their charters than the untrained and unsuspecting public. It makes the ordinary citizen guarantee the corporation and its stockholders against the corporation exceeding its powers, instead of the corporation and its stockholders themselves assuming that responsibility, as they should.”⁸

We must now proceed to examine critically the various grounds of invalidity which have been asserted against *ultra vires* contracts. These are: (1) Lack of power or capacity conferred by law; (2) illegality, or violation of express or implied prohibition; violation of public interest; (3) breach of trust or violation of the rights of the stockholders to confine capital to purposes specified; (4) constructive notice of limits of charter power; (5) lack of authority in directors and corporate officers to act outside the scope of the business authorized; (6) rights of *intra vires* creditors.

The reasons advanced in favor of enforcing *ultra vires* contracts, particularly when executed on one side, are as follows:

1. The doctrine of general capacity as contrasted with the doctrine of special capacity; capacity to do wrong or incur liability.

2. Disregard of the metaphor of corporate personality; and treating a corporation as an association of natural persons, like a partnership.

3. “Estoppel” arising from the receipt of benefits by part performance.

4. “Estoppel” arising from acquiescence in a course of *ultra vires* business.

5. Ratification or assent of the stockholders.

6. The demands of honesty and fair dealing.

§ 68. *Ultra vires* acts as the acts of the corporation.—A corporation may acquire rights and incur liabilities through an *ultra vires* act done on its behalf. Many courts, however, discuss the doctrine in terms of the power or capacity of the corporation considered as an artificial person endowed by law with special or limited capacity to act. But it ought to be regarded as primarily a question of the effect of limitations on the authority of the corporate representatives by the contract of the shareholders contained in the charter.

The doctrine so often laid down by the courts,—that a corporation has such powers only as are conferred upon it by its charter,—

⁸ Clarke on California Corporations, p. 94.

if taken literally, would be equivalent to saying that an act done by the officers of a corporation on its behalf and in its name, but in excess of its authorized business, even though assented to by all the stockholders, is not the act of the corporation at all, or, in other words, that it is impossible for a corporation, as distinguished from its officers and stockholders, to do an act which is not authorized by its charter; and in some of the earlier cases it was so held. In an Ohio case, for instance, where a corporation, acting *ultra vires*, had entered into a contract and taken the note of a third person indorsed by the other party to the contract, it was held that the corporation acquired no title to the note and could not enforce it. The court said: "As well might a dead man, by the mere act of the indorser, be invested with the legal interest, as a corporation, which only lives for the purposes and objects intended by the legislature. Beyond these limites it has no existence, and its acts are neither more nor less than a nullity."⁹ This view, however, cannot be sustained. If corporation A purchases a promissory made by B and held by C, the corporation may sue in its own name against the maker or indorser without regard to the question whether the purchase was one which it was authorized by law to make.¹⁰

The doctrine of *ultra vires* seems for many courts to take its origin in a deduction from the conception of corporations as artificial persons, creatures of the law, with no powers or existence except for the purposes for which they are created. Hence an act done by agents in the name of the corporation and by authority of its directors and even with the consent of all the stockholders is held by such courts not to be the act of the corporation.¹¹

⁹ *Straus v. Eagle Ins. Co.*, 5 Ohio St. 60. See also, *Davis v. Old Colony R. Co.*, 131 Mass. 258, 41 Am. Rep. 221; *Ashbury Railway Carriage & Iron Co. v. Riche*, L. R. 7 H. L. 653; *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24, 35 L. Ed. 55, 11 Sup. Ct. 478.

¹⁰ *National Pemberton Bank v. Porter*, 125 Mass. 333, 28 Am. Rep. 235; *Merchants Nat. Bank v. Hanson*, 33 Minn. 40, 21 N. W. 849, 53 Am. Rep. 5. See note L. R. A. 1917 B 841; 2 Machen, Corporations, § 1048.

"The act of purchase of the stock might be *ultra vires* because . . .

unauthorized by its charter, and still it would not follow that such act would not give rise to legal or equitable rights and liabilities. . . . The better view is that there is nothing in the nature of a corporation which would prevent it from acquiring rights and incurring liabilities through an *ultra vires* act." Fly, J., in *San Antonio Hardware Co. v. Sanger* (Tex.), 151 S. W. 1104, 1106.

¹¹ *Head v. Providence Ins. Co.*, 2 Cranch (U. S.) 127, 150, 2 L. Ed. 229; *Bank of United States v. Dandridge*, 12 Wheat. (U. S.) 64, 6 L. Ed. 552; *Straus v. Eagle Ins. Co.* of Cincinnati, 5 Ohio St. 59, 60.

In *Ashbury Ry. Co. v. Riche*,¹² the leading English case, the defendant company was created, having for its objects, to make or sell, lend or hire, railway equipment, to carry on the business of engineers and general contractors, etc. The directors agreed to purchase a concession for making a railway in a foreign country. The contract had been partly performed by the plaintiff, but the company repudiated the contract as *ultra vires*. The company was sued for damages for breach of contract. It was held that the contract was *ultra vires* and not within the objects set forth in the memorandum of association. Even the subsequent assent of all the shareholders could not ratify it. Under the provisions of the Joint Stock Company Act of 1862, the company had no capacity to do an act outside of the contemplated activities. Therefore, the contract made in the name of the company by its directors with the sanction of all its stockholders did not render the company liable even when partly executed. The House of Lords found an implied statutory prohibition of contracts in excess of the specified objects. The case goes on the ground of statutory limited capacity, so that the contract is a mere nullity which could not be authorized or ratified even by all of the stockholders. This overlooks the point that the powers of such companies are not defined by statute but are dependent upon the terms of a mere contract, namely the memorandum of association.

In the Ashbury Railway Company case the corporation was organized under a general act which allowed the shareholders, by the memorandum of association, to determine the purposes for which the corporation should be organized. It might well have been held that since the shareholders had the power of determining the scope of the company's powers or business at the start, that a contract with an innocent third person, having the sanction of all the shareholders, should be binding. Very great hardships may fall on third persons if a transaction is always to be held void, though ratified by all the shareholders. The contract was made in

¹² L. R. 7 H. L. 653. Compare *Riche v. Ashbury*, L. R. 9 Exch. 244, 247, 252-264. See *British S. Africa Co. v. De Beers Mines Co.*, [1910] 1 Ch. 354, 374; 2 Cambridge Law Journal 350; 42 Canadian Law Times 497, 632, 679. In an article, *Torts by corporations in ultra vires undertakings*, 2 Cambridge Law Journal 180, 187-189, Professor Warren

criticises *Ashbury Co. v. Riche*, and the opinion of Lord Cairns on the ground that the provisions of the Companies Act upon which Lord Cairns relied furnish an insufficient basis for concluding that the Legislature intended that a company should have no capacity to incur liability for an *ultra vires* act. Cp. 2 Cambridge Law Journal 350.

the name of the company for its benefit by its directors, and with the assent of all of its stockholders, and was partly performed; yet the company was not subjected to any liability.

A peculiar distinction is drawn in England and Canada between a statutory corporation which has capacity to contract only for the purposes for which it was created, and a chartered company created by Royal Letters Patent which apparently has unlimited capacity to contract.¹³

In *Central Transp. Co. v. Pullman's Palace Car Co.*,¹⁴ Mr. Justice Gray of the U. S. Supreme Court laid it down that, "a contract of a corporation which is *ultra vires*, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void and of no legal effect. The objection to the contract is not merely that the corporation ought not to have made it, but that it could not make it." Suppose that A executes to corporation B a conveyance of real or personal property which B is not authorized to acquire or hold for the purpose intended. B later purports to convey the property to C. Where is the title? If B has no power or capacity to do these acts, they are void and the title is still in A. Yet, as we shall see, such is not the law. Even the federal courts which deny the corporation power to make *ultra vires* contracts, recognize that legal rights may arise from *ultra vires* acts, as where a corporation takes security *ultra vires*, or where it acquires or transfers title, or where the grantor or his heirs attack the title to property conveyed to a corporation *ultra vires*.¹⁵

A private corporation is not to be regarded as in reality a person created by act of law and invested with specified corporate powers and capacities, but as an association for business purposes, formed by act or contract of the parties under permission and formalities

¹³ *Riche v. Ashbury Ry. Carriage Co.*, L. R. 9 Exch. 224, 262; *Edwards v. Blackmore*, 42 Ont. L. Rep. 105, 42 Dom. Law Rep. 280; *Bonanza Creek, etc., Co. v. Rex*, [1916] 1 A. C. 566, 584, 26 D. L. R. 273; *Re Northwestern Trust Co.*, [1926] 1 D. L. R. 689, 25 Que. K. B. 170. See 40 Canadian Law Times 993; 42 Canadian Law Times 143, 245, 320; 2 Cambridge Law Journal 180, 350; Holdsworth, *History of English Law*, vol. 9, pp. 56, 61, 62.

¹⁴ 139 U. S. 24, 35 L. Ed. 55, 11 Sup. Ct. 478. This is an over-emphatic and inaccurate statement even of the strict doctrine of the federal courts. See 2 Machen, *Corporations*, sec. 1043; Warren, 23 *Harvard Law Rev.* 495.

¹⁵ Carpenter, *Doctrine of ultra vires*, 33 *Yale Law Journal*, 52-55; Harno, *Privileges and powers of corporations*, 35 *Yale Law Journal* 13, 25-27.

given by the law.¹⁶ When it is said that the corporation is invested with certain corporate powers, this means that the association is invested by the act of those who form it with authority to carry on certain lines of business by its officers. The supposed premise that a corporation is a legal person is a mere metaphor, not a legal proposition. In dealing with this subject we must discard fiction or figure of speech, and recognize the fact that "shareholders are in substance partners in a trading concern the management of which is committed to the body corporate."¹⁷ Powers are not to be regarded as being delegated to the corporation by the state, but it is rather a question of what the stockholders may be considered to have authorized the corporate representatives to do in their behalf.

The whole terminology of the law as to exercise of "powers" by a corporation is highly artificial and misleading. A corporation itself has no powers and can do no act. It acts only through agents and representatives. All corporate liability and action are vicarious. The law can attribute or ascribe to the corporation such acts and contracts as its agents may be deemed authorized to do or make on its behalf, or for which it may be justly responsible.¹⁸ Crimes and torts are never authorized, and yet it is well settled that a corporation may become liable in tort for acts of its servants in the scope of their employment, even in *ultra vires* business, and may likewise incur criminal responsibility. This is sufficient to show that the question of contract liability cannot be decided in terms of power or capacity to do acts outside of or be-

16 Morawetz, Corporations, secs. 7, 24, 649. Compare Waters Peirce Oil Co. v. Texas, 177 U. S. 28, 43, 44 L. Ed. 657, 20 Sup. Ct. 518: "The state prescribes the purposes of a corporation and the means of executing those purposes."

17 Blackburn, J., in Taylor v. Chester, etc., Ry. Co., L. R. 2 Exch. 356. See 2 Morawetz, Corporations (2d Ed.), sec. 649. Compare Marshall, C. J., dissenting in Bank of United States v. Dandridge, 12 Wheat. (U. S.) 64, 90, 97, 6 L. Ed. 552.

18 "A corporation acts through human beings, and the question whether a corporation has acted is always to be answered by inquiring (a) whether human beings have acted, and (b) whether it is proper

to give corporate significance to their acts." Warren, 2 Cambridge Law Journal 180, 183. Is *ultra vires* a question of "power," "capacity," "authority" of the corporation or of the directors? Is it not always a question of "liability" in the corporate body to the exercise of a power by the directors or those deriving authority under them to confer rights or impose liabilities by acts done in behalf of the corporation? Compare Harno, Privileges and powers of corporations, 35 Yale Law Journal 13. This terminology of "powers" and "capacities" has become "saddled onto the backs of the courts, like Sinbad's old man of the sea, not to be shaken off." See G. H. W., 6 Cent. Law Journal 2.

yond the authorized corporate purposes. It was once contended that a corporation could not be liable in tort, because a corporation never is authorized or empowered by law to commit a tort. It is outside the scope of its corporate powers. But it was pointed out by the Pennsylvania court that the argument was fallacious in its principles and mischievous in its consequences.¹⁹

The formulá that a corporation has no "*powers*" expect such as are conferred by its charter cannot and does not mean that it has no "*capacity*" to acquire rights and liabilities by the *ultra vires* acts of its representatives. A corporation has no *authority* to do acts which are not within the scope of its business, but, as in the case of an individual, the law may find ground to ascribe to it legal responsibility for acts done by its agents, though not strictly authorized. They may exceed its proper corporate purposes and do an *ultra vires* act, and the act will be, in contemplation of the law, not merely the act of the officers or stockholders, but the act of the corporation itself.²⁰ "Like natural persons," said Chief Justice Comstock in a New York case, corporations "can overleap the legal and moral restraints imposed upon them: in other words, they are capable of doing wrong. . . . The distinction . . . is no more to be lost sight of in respect to artificial than in respect to natural persons."²¹ It is obvious, says Mr. Morawetz, "that the words *powers* and *vires* are here used in the sense of *authority* or *right*, and not in the sense of *ability*."²²

§ 69. Objection on ground of illegality and public interest.—
Ultra vires contracts are frequently declared to be void on

¹⁹ Chestnut Hill & Spring House Turnpike Co. v. Rutter, 4 Serg. & R. (Pa.) 6, 8 Am. Dec. 675; Warren, 23 Harvard Law Rev. 498; 21 Columbia Law Rev. 475; 2 Machen, § 1072; 2 Cambridge Law Journal 180.

²⁰ Bissell v. Michigan Southern & N. I. R. Co., 22 N. Y. 258, 259; People v. North River Sugar Refining Co., 121 N. Y. 582, 24 N. E. 434, 9 L. R. A. 33, 18 Am. St. Rep. 843; Life & Fire Ins. Co. v. Mechanic Fire Ins. Co., 7 Wend. (N. Y.) 31; Denver Fire Ins. Co. v. McClelland, 9 Colo. 11, 9 Pac. 771, 59 Am. Rep. 134; San Antonio Hardware Co. v. Sanger (Tex.), 151 S. W. 1104, 1106.

The term "*capacity*" or "*power*" should be avoided. "When we say that a corporation has legal ca-

capacity to do an act, we do not mean that the corporation itself has done the act. What is meant is that a duly authorized agent of the corporation has done an act which is attributed to the corporation. It is, therefore, a question of agency in all cases." The issue as to *ultra vires* contract is, "ought a corporation to be bound by contracts entered into in its name by persons who are not its agents, or who are acting outside the scope of their agency?" 2 Cambridge Law Journal 350, Goodhart, Corporate liability in tort and doctrine of *ultra vires*.

²¹ Bissell v. Michigan Southern & N. I. R. Co., 22 N. Y. 258.

²² Morawetz, Corporations (2nd Ed.), sec. 648.

grounds of illegality and violation of public interest. This is not a valid ground of objection except perhaps in certain classes of corporations having a fiduciary character or a more or less public service business. An express prohibition sometimes renders a contract illegal.

The expression "*ultra vires*" is sometimes applied to acts of a corporation which are illegal as contrary to some settled principle of public policy, or in violation of an express prohibition in its charter or some statute. Such an act is illegal because forbidden in the public interest, not merely because it is "*ultra vires*," or beyond the scope of the specified corporate business. The liabilities arising from a forbidden contract are different from those which arise from an act which is "*ultra vires*" in the proper sense as merely outside the scope of the charter. "*Ultra vires* and illegality represent totally different ideas."²³ A contract may be *ultra vires* and yet not "illegal." Is there any basis for distinguishing between acts which are merely outside the sphere of corporate business or purposes and acts which are expressly forbidden? Some courts say no; that an act which does not aid in the accomplishment of corporate ends is impliedly forbidden, and an express legislative prohibition would not make it any more illegal.

In the leading N. Y. case of *Bissell v. Michigan Southern & N. I. R. Co.*,²⁴ a Michigan corporation and an Indiana corporation, each with power to build and operate a railroad within its own state, united in the business of transporting passengers over a third road in Illinois, beyond the limits authorized by the charter of either of the defendants. Plaintiff was injured in Illinois by the negligence of their employees. Counsel on both sides treated the action as founded in contract for breach of defendant's undertaking to carry plaintiff safely. The defense was *ultra vires*, or want of authority to make such a contract, and that therefore it was void. It was held that the defendants were jointly liable,

²³ *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24, 35 L. Ed. 55, 11 Sup. Ct. 478; *Maryland Trust Co. v. National Mechanics' Bank*, 102 Md. 608, 63 Atl. 70. See *Thomas v. West Jersey R. Co.*, 101 U. S. 71, 25 L. Ed. 950; *White v. Franklin Bank*, 22 Pick. (Mass.) 181; *Commonwealth v. Smith*, 10 Allen (Mass.) 448, 87 Am. Dec. 672, note 70 Am. St. Rep. 156, 157; *National Inv. Co. v. National Sav. L.*

& B. Ass'n, 49 Minn. 517, 52 N. W. 138 (distinction drawn between defense of *ultra vires*, or mere excess of authority and defense that contract is expressly prohibited by statute, or illegality); *Staacke v. Routledge*, 111 Tex. 489, 241 S. W. 994; *Jackson v. Western Union Telegraph Co.*, 269 Fed. 598. See L. R. A. 1916A 792 note.

²⁴ 22 N. Y. 258.

either on contract or in tort. In elaborate opinions Comstock, Ch. J., and Selden, J., advanced different theories as to the ground and effect of the defense of *ultra vires*. The first question raised was whether an *ultra vires* act done on behalf of a corporation is a corporate act at all, and both agreed that the corporation may be responsible. Corporations have capacity to do wrong. Comstock's theory in essence was that the defense of *ultra vires* rests on a violation of trust or duty by the corporation to the shareholders, and is not to be entertained where its allowance would do a greater wrong to innocent third parties. The acquiescence of the shareholders in the abuse will prevent the use of such plea. When a corporation has received the consideration of its unauthorized contract, the remedy of the other party is not confined to a suit for restitution, in disaffirmance of the contract, but suit may be brought directly upon it for damages.

Selden J., on the other hand, advanced the theory that the powers and privileges of corporations are conferred, not for private convenience, but for public purposes and to promote the public interest. If corporations are permitted to usurp powers not granted, it is done at the expense of the public. Every contract made by them which exceeds the chartered limits is in contravention of public policy, illegal and void.²⁵ It is a defense, according to Selden, that the corporation exceeded its corporate powers; this defense being allowed not for the sake of the stockholders, as Comstock Ch. J. contended, but for that of the public.²⁶ But if in the course of performance of an *ultra vires* contract, the agents of the corporation are guilty of negligence, the liability of the corporation arises not from any contract obligation, but from a

²⁵ Justice Selden seems to confuse corporate objects and powers with secondary franchises, such as the privilege of eminent domain or use of the highways by a public utility. He seems to forget that modern business corporations are no longer confined to the exercise of public franchises, but are in effect registered partnerships, and that in general no public interest or policy is involved in the scope of the business authorized or carried on, which is merely a matter of contract between the stockholders and authority to the directors. The doctrine of *ultra vires* while modern in development seems to rest on notions about corporations which originated at a

time when corporations were created by special act and largely for public purposes for the exercise of special franchises. See *Holm v. Claus Lipsius Brewing Co.*, 21 N. Y. App. Div. 204, 47 N. Y. Supp. 518; *Thompson on Corporations*, sec. 5969.

²⁶ Selden, J., remarks that "the real ground upon which the defense of *ultra vires* rests, and the only one upon which it has ever, to any extent, been judicially based, is that the contracts of corporations which are unauthorized by their charters are to be regarded as illegal, and therefore void." *Bissell v. Michigan Southern & N. I. R. Co.*, 22 N. Y. 258, 285.

duty imposed by law to use due care to one lawfully on their cars by their consent and not as a trespasser. Comstock's point of view would seem much more in line with the modern tendency of the law than that of Selden.

If the transaction is one into which the corporation might freely enter by merely amending its articles, it seems fictitious to say that the public is interested in preventing the corporation from entering the transaction. All that the state requires is that the powers of the corporation be made a matter of public record and that the basic agreement of the stockholders be amended in an orderly way. The mere fact that the corporation exceeds its charter powers does not involve any usurpation adverse to the public interest.²⁷ Business corporations are, in everything but form of organization, substantially mere partnerships, and no one should be allowed to complain of *ultra vires* acts but those who have some interest which is invaded by the excess of authority, that is for the most part only the stockholders. Incorporation laws permit the formation of corporations with any or all powers that may be exercised by natural persons. The limitations on the powers are merely matters of contract and agency in which the public has no interest.

In *Bank of Michigan v. Niles* ^{27a} a bank contracted to acquire and transfer to the defendant certain real estate. The bank was restricted to holding such land as should be required for its own accommodation. It acquired the land in part performance of its contract and sought specific performance against the buyer, but it was held no relief could be given on the ground of illegality. What is the practical result? The bank is left with real estate on its hands which it had no right to hold.

²⁷ Carpenter, 33 Yale Law Journal 64. With respect to business and trading corporations the defense of *ultra vires* is not looked upon with favor, though it is different as to banks, trust companies and those of a fiduciary or public nature. *Gause v. Commonwealth Trust Co.*, 196 N. Y. 134, 153, 89 N. E. 476, 24 L. R. A. (N. S.) 967; *Scandinavian Import-Export Co. v. Bachman*, 195 N. Y. App. Div. 297, 186 N. Y. Supp. 860; *Kellogg-MacKay Co. v. Havre Hotel Co.*, 199 Fed. 727. "The rule of *ultra vires* differs materially in its application to public or to municipal corporations."

^{27a} Walk. (Mich.) 99, 1 Doug. 401, 41 Am. Dec. 575. Whose rights or interests would have been violated by granting specific performance in this case? The corporation was not seeking to acquire or hold land, but to get rid of it and had tendered a deed to the defendant. The court stultifies itself. Cp. *Case v. Kelly*, 133 U. S. 21, 33 L. Ed. 513, 10 Sup. Ct. 216. It is an entirely different situation where the court refuses to make itself the active agent to enable the company to acquire title to land which the law forbids it to hold.

Prohibition merely declaratory of common-law doctrine of *ultra vires*.—A provision in a general corporation law that no corporation created thereunder shall employ its assets for any other purpose than to accomplish the legitimate objects of its creation is merely declaratory of the common-law rule by which corporations are confined in their powers to the purposes for which they are created, and does not amount to such an express statutory prohibition of *ultra vires* loans and other transactions as to render them illegal instead of *ultra vires* merely.²³ The effect of a prohibition depends on the supposed intention and purpose of the legislature as to the interests to be protected. An express prohibition against certain transactions, such as a contract by a corporation to purchase its own shares, may be construed to express a strong policy which requires that the contract should not be enforced under any circumstances. As a federal court said in regard to such a case: "If the contract is *ultra vires*, and beyond the powers of either the board of directors or the stockholders to make, the facts pleaded as an estoppel constitute no defense. To permit corporations to contract by estoppel, where contracts are prohibited by law, would in effect override the statute." ^{23a}

§ 70. Limitation on authority of directors by charter.—Transactions beyond the specified objects of the corporation are not within the actual authority of the directors or agents to bind the corporation, even if the theory of general capacity as contrasted with special capacity be adopted.

The expression "*ultra vires*" has been applied to acts done by the directors or other officers of a corporation in excess of the authority conferred upon them by the stockholders; thus an act may be done without complying with certain conditions such as obtaining a vote or consent of the stockholders to a contract where that is required. Such an act, however, is not necessarily *ultra*

²³ Bond v. Terrell Cotton & Wool-en Mfg. Co., 82 Tex. 309, 18 S. W. 691; Butterworth & Lowe v. Kritzer Milling Co., 115 Mich. 1, 72 N. W. 990; Joseph Schlitz Brewing Co. v. Missouri Poultry & Game Co., 287 Mo. 400, 229 S. W. 813; Harris v. Independence Gas Co., 76 Kan. 750, 762, 92 Pac. 1123, 1127, 13 L. R. A. (N. S.) 1171; Douglass v. State Bank, 77 Fla. 830, 82 So. 593; Fletcher, Corporations, secs. 1512, 1617.

^{23a} E. J. Dodge Co. v. First Nat. Bank, 260 Fed. 758. A California corporation cannot make a valid contract for the purchase of its own stock, under Civ. Code Cal., sec. 309, and may sue to cancel such a contract and recover all sums paid under it. But it is doubtful whether this is the case if the purchase is made out of surplus and not out of capital.

vires the corporation. An act may be within the powers of a corporation and yet not within the authority of the directors, for the powers of the latter, though in general co-extensive with the purposes of the corporation, may be limited as to certain matters of corporate business.²⁹

Objects of corporation and authority of agents.—The power over the property and business of the corporation given to the board of directors is very extensive. But this authority is subject to the implied condition that it shall be exercised solely in pursuance of the company's chartered purposes, and for the benefit of the stockholders. "Any departure from the chartered purposes of a corporation is an injury to every individual shareholder, for which the courts will, under proper circumstances, provide a remedy."³⁰ The limitation of "powers" is properly derived not from any grant or prohibition by the state, but from the circumstance that the articles or charter is a contract between the stockholders and the corporation as to what activities are authorized and in what enterprises their joint capital may be risked. The officers are only authorized to do in the corporate name those acts which are incidental to the specified business.

In modern business corporations, the authorized lines of business are limited to specified enterprises chiefly because it is for the protection of the stockholders that they have some control over the purposes for which the funds invested are to be used. If a stockholder contributes funds or makes an investment in one enterprise, he should have a right to insist that they should not be diverted to or risked in another, even though a majority of the stockholders may approve. If the officers or directors assume in the name of the corporation to make a contract which is foreign to the scope of the business as defined in the articles, the third party dealing with the corporate agents ought not to be able to hold the corporation responsible to any greater extent than any third party is entitled to hold a principal in a contract which an agent has assumed to make in the name of the principal, but be-

²⁹ See *Ashbury Railway Carriage & Iron Co. v. Riche*, L. R. 7 H. L. 653; *Louisville, N. A. & C. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552, 570, 43 L. Ed. 1081, 19 Sup. Ct. 817; *Bell v. Kirkland*, 102 Minn. 213, 113 N. W. 271, 13 L. R. A. (N. S.) 793, 120 Am. St. Rep. 621; *Machen, Corporations*, sec. 1475.

³⁰ *Morawetz, Corporations*, sec. 274. The directors and agents of the corporation have no actual authority beyond what is conferred upon them by the agreement of the shareholders as set out in the charter or articles. See also, *Comstock, C. J.*, in *Bissell v. Michigan Southern & N. I. R. Co.*, 22 N. Y. 258.

yond the scope of the agent's authority.³¹ This theory would seem to indicate the true basis and limits of the doctrine of *ultra vires*, which is similar to the rules as to the rights and liabilities of partners as to the scope of the firm business.³² In general the board of directors have the same authority to bind the corporation in managing the company's business that a partner would have in an ordinary partnership to bind the firm. Such an authority must be exercised within the limitations of the ordinary business of the firm. A corporation like an individual or a partnership may acquire rights and may be held responsible for contracts through acts of agents beyond those authorized on grounds of adoption, ratification and estoppel. The law may ascribe to the corporation such liabilities for crime, tort or breach of contract as policy and justice may require even though manifestly beyond the objects specified in the articles.

In an Ontario case³³ a corporation whose object was to carry on a real estate business gave a note for the purchase of machinery and patent rights for the manufacture of machines for pressing clothes. In an action on the note, the defense was *ultra vires*, as the purchase was not within the objects specified in the charter. The contract had been executed on the part of the plaintiff by the delivery of the machinery. The court held the corporation liable, because the president and general manager had apparent authority to execute the contract and make the note, and the plaintiff had no notice that the contract was beyond the objects of the company as expressed in the charter. It was admitted, however, that the directors or the manager might have no implied authority to bind the company to a contract not within the scope of the

³¹ Should the doctrine of *ultra vires* be discarded? C. E. Carpenter, 33 Yale Law Journal 49.

³² Natusch v. Irving (1824) Gow on Partnership, App. VI, p. 398, a partner has the right to hold his partners to the specified purposes and lines of business while the partnership continues.

Lilienthal, 11 Harv. Law Rev. 387, 394, Non-public corporations and *ultra vires*: "So far as a copartnership has power to restrict the scope of its business by the terms of the partnership articles, so similarly it is to be said that as between the stockholders themselves, or the stockholders and the corporation, no

corporation should engage in any enterprise not contemplated by the corporate charter." But no one should be heard to complain of usurpation but stockholders who are injured or possibly creditors. Only private and not public interests are affected.

³³ Edwards v. Blackmore [1918] 42 Ont. L. Rep. 105, 42 D. L. R. 280. See 39 Can. Law Times, 79; 40 Can. Law Times 832; 42 Can. Law Times 466, 531. Compare Canadian Bank v. Cudworth, etc., Co., Ltd., [1923] 4 D. L. R. 16, 67 D. L. R. 723; Re Northwestern Trust Co., [1926] 1 D. L. R. 689.

objects or purposes of the company, even though the company had capacity to be bound.

The Ontario Act of 1916, ch. 35, sec. 6, declares that: "Every corporation or company heretofore or hereafter created . . . (e) . . . shall have the general capacity which the common-law ordinarily attaches to corporations created by charter." It was held that by this legislation all limitation upon the capacity of the corporation had been annulled. It adopts the theory of general capacities, that a corporation shall be deemed to have the capacities of a natural person.³⁴

It has been objected that if the doctrine of special or limited capacities is discarded that a company incorporated for the mining business may devote its capital to the laundry business, or a company incorporated to carry on a "real estate and insurance" business, may indulge in the speculative buying of patents and the manufacturing of new devices, or the business of butchering. This does not follow in the least. The limits of authorized action are those defined by the articles. An attempt by directors or officers to do an *ultra vires* act would be in excess of their powers as agents for the corporate body of shareholders and therefore not corporate action unless ratified or adopted, and might be enjoined by the stockholders. The adoption of the general capacities doctrine would not greatly modify the rules as at present applied by the majority of courts.^{34a}

³⁴ Edwards v. Blackmore, 42 Ont. L. Rep. 105, 42 D. L. R. 280. Cp. Re Northwestern Trust Co., [1926] 1 D. L. R. 689. Mr. George Wharton Pepper in an article in 8 Yale L. J., 24, 31, concludes that: "It is submitted that we shall never see our commercial law in a satisfactory state until the courts re-establish the common-law doctrine of general capacities, treating contracts made beyond the limits of chartered activity as contracts prohibited but not void—and leaving the state to punish the disregard of the prohibition, while enforcing the contract between the parties. The enforcement of corporate contracts in spite of objections as to corporate power represents the overwhelming tendency of American decisions." See article by James Lewis Parks, *Ultra Vires Transactions*, 25 Univ. of Missouri L. Bul. 3; 26 Univ. of Mis-

souri L. Bul. 3. See also, E. H. Warren, 24 Harv. Law Rev. 544, and 23 Harv. Law Rev. 495; G. W. Pepper, 9 Harv. Law Rev. 255.

^{34a} Geo. Wharton Pepper, 9 Harvard Law Rev. 255, 268, the unauthorized or prohibited exercise of corporate power; "a dissenting minority of stockholders would still have all the rights of a partner in respect of confining his associates to the enterprise to which he agreed to contribute his capital."

In *Riche v. Ashbury, etc., Co., Ltd.*, L. R. 9 Exch. 252, 255, Blackburn, J., says that the board of directors "have the same authority to bind the company in managing the company's business that a partner or manager in an ordinary partnership, established at common law for the same objects, would have to bind the firm; an authority which to be valid must be exercised in cases

The doctrine of general capacity does not mean that the directors may divert the capital of the corporation in their discretion or that stockholders have no control as to the nature of the business which the corporation might carry on. The objects clause still limits the authority of the managing body and the power of the majority to bind the minority. But it would no longer be a defense to the corporation or to the person who contracted with it to say that a contract was beyond the capacity of the corporation if actually or ostensibly authorized or ratified. Unauthorized corporate action would not be sanctioned or condoned by the enactment of a statute that every corporation shall be deemed to have the capacities of a natural person, but such enactment should be construed merely to remove artificial obstacles to the enforcement of rights or liabilities which ought to arise from transactions done on behalf of the corporation as between the corporation and third parties. The remedy of the corporation might be to sue the directors for breach of duty.

II. RIGHTS AND LIABILITIES ARISING FROM ULTRA VIRES CONTRACTS.

§ 71. In general.—The courts do not agree as to the effect of an ultra vires contract with a corporation. The following may be given as a summary of the decisions,

- (1) If the contract is fully executed on both sides, the courts will not interfere to deprive either party of what has been acquired under it except in England.
- (2) If the contract is executory on both sides, as a rule neither party can maintain an action, either for specific performance or to recover damages for nonperformance. And this rule applies notwithstanding the contract has been partly performed on one or both sides.
- (3) Where the contract is executory on one side only, and has been fully executed on the other, so that one of the parties has furnished the consideration, in money, property, or services, for the promise of the other, the courts differ as to whether an action will lie on the contract by the party thus furnishing the consideration.

within the scope of the ordinary business and transactions of the firm." Blackburn, J., was of opinion that ratification by unanimous

assent of the shareholders would make an *ultra vires* contract binding on the company.

- (a) Some courts hold that the express contract is void, and that no action will lie upon it, the obligation, if any, being quasi contractual for the value of what has been received under the contract. This is the federal view.
- (b) A majority of courts hold that the party thus receiving the consideration is estopped to set up that the contract is *ultra vires*, in order to defeat an action on the contract.

Ultra vires contracts may be classified. for the purpose of determining their effect into:

(1) Contracts executed on both sides, which, as we have seen, the courts will not set aside or interfere with for the purpose of depriving either party of what has been acquired under them.

(2) Contracts executory on both sides, which will not be enforced at the suit of either party.

(3) Contracts executed on one side, and executory on the other, which the courts in some jurisdictions, although not in all, will enforce in favor of the party who has executed the same on his part against the other party who has received and retains the benefits.

(4) Contracts, whether wholly executory or executed on one side, apparently authorized, but in fact *ultra vires* because made for a purpose not within the scope of the business of the corporation, or made without observing prescribed formalities, the *ultra vires* purpose, or the failure to observe the prescribed formalities, being unknown to the other party,—which contracts, as we shall presently see, are enforceable against the corporation.

(5) Contracts (which might be classified with those just mentioned) evidenced by a negotiable instrument, which, as we have seen, is valid and binding upon the corporation in the hands of a *bona fide* purchaser, the instrument being apparently within the powers of the corporation, but having in fact been given for an *ultra vires* purpose, or in an *ultra vires* transaction.

(6) Contracts which are not only *ultra vires*, but also illegal, because in violation of an express statutory prohibition, or contrary to public policy, such contracts being void because of their illegality, aside from the fact that they are also *ultra vires*, on the same principles which render void illegal contracts between individuals.

§ 72. Contracts executed on both sides.

When an *ultra vires* contract with a corporation has been fully performed on both sides, neither party can maintain an action to set aside the transaction or to recover what has been parted with. In other words, neither a court of law nor a court of equity will interfere in such a case to deprive either the corporation or the other party of money or property acquired under the contract.³⁵ In a case carried to the United States Supreme Court³⁶ an action was brought to set aside a deed to a national bank and also a deed by which the bank purported to convey the same property on the ground that the bank was without power to take real property, and hence that no title passed by the deed, but remained in the grantor. It was held that a conveyance of real estate to a bank or other corporation for a purpose not authorized by its charter as one for which it may acquire and hold real estate is *ultra vires*, but it does not follow the deed is a nullity and fails to convey the title to the property. This rule has the salutary effect of assuring the security of titles conveyed to and by corporations, which otherwise might be subject to doubt and uncertainty.

The rule that executed *ultra vires* transactions are effective as a foundation of rights in the corporation or in the third party holds true even in those jurisdictions in which it is held, that performance of an *ultra vires* contract by one of the parties does not make it enforceable against the other.

Illustrations.—Thus, it has been held that after a corporation has made a loan and taken a pledge of property as security, and has disposed of the property and applied the proceeds to the

³⁵ First Nat. Bank of Xenia v. Stewart, 107 U. S. 676; Long v. Georgia Pac. Ry. Co., 91 Ala. 519, 8 So. 706, 24 Am. St. Rep. 931 (bill to rescind conveyance to corporation which had paid the purchase price, held, grantor not prejudiced or injured by lack of authority of the corporation); Leazure v. Hillegas, 7 Serg. & R. (Pa.) 313; Parish v. Wheeler, 22 N. Y. 494; Holmes v. Griggs Co. v. Holmes & Wessell Metal Co., 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448; Fayette Land Co. v. Louisville & N. R. Co., 93 Va. 274, 24 S. E. 1016. Warren, Executed *ultra vires* transactions, 23 Harv. Law Rev. 495, 505. Stevens, 36 Yale Law Journ. 297, 305.

“Under the great weight of au-

thority, state and federal, the plea of *ultra vires* cannot be used as a sword to recover back money paid under an executed *ultra vires* contract, although it may be used, under certain circumstances as a shield to defend against the enforcement of such a contract.” National Bank of Commerce in St. Louis v. Francis, 206 Mo. 169, 246 S. W. 326.

Memphis Lumber Co. v. Security Bank & Trust Co., 143 Tenn. 136, 226 S. W. 182, (corporation cannot sue to avoid *ultra vires* transaction fully executed); Providence Engineering Corporation v. Downey Shipbuilding Corp., 294 Fed. 641, 660.

³⁶ Kerfoot v. Farmers' & Merchants' Bank, 218 U. S. 281, 54 L. Ed. 1042, 31 Sup. Ct. 14.

payment of the loan, the borrower cannot maintain an action to recover the proceeds of the property on the ground that the taking of the security was *ultra vires*.³⁷ If a corporation enters into an *ultra vires* contract to purchase property, real or personal and the contract is fully performed by a conveyance or transfer of the title, the effect of the transaction is to vest the title in the corporation, at least as against all persons but the state, and the corporation may afterwards sell the same.³⁸ The other party cannot, in such a case, maintain a suit to rescind the sale and recover the property.³⁹ The same is true of a contract by a corporation to sell property, real or personal, which is fully executed. The title to the property passes by the conveyance or transfer, and the corporation cannot maintain a suit to rescind and to recover the property.⁴⁰

Suppose that the A Co. purchases 10 shares of stock in the B Co., and that the purchase is *ultra vires* of the A Co. It has been held that when a corporation makes an *ultra vires* purchase of stock in another corporation, and the contract is fully executed by both parties, it cannot compel the other corporation to transfer the stock to it on the books, so as to entitle it to vote at the meetings of stockholders, or vote after such a transfer.⁴¹ This may perhaps be supported on the theory that a corporation is probably prohibited from holding stock in another corporation to prevent it from controlling or interfering in the management of rival corporations. To permit A to vote might allow the very thing which it was the policy of the law to prevent. Even an executed transaction may

³⁷ First Nat. Bank of Xenia v. Stewart, 107 U. S. 676, 27 L. Ed. 592, 2 Sup. Ct. 778; National Bank v. Matthews, 98 U. S. 621, 25 L. Ed. 188. See 29 Harvard Law Rev. 320.

³⁸ Leazure v. Hillegas, 7 Serg. & R. (Pa.) 313; Fayette Land Co. v. Louisville & Nashville R. Co., 93 Va. 274; Parish v. Wheeler, 22 N. Y. 494; Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co., 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448; Hough v. Cook County Land Co., 73 Ill. 23, 24 Am. Rep. 230; Kerfoot v. Farmers' & Merchants' Bank, 218 U. S. 281, 54 L. Ed. 1042, 31 Sup. Ct. 14.

³⁹ Long v. Georgia Pac. Ry. Co., 91 Ala. 519, 8 So. 706, 24 Am. St. Rep. 931.

⁴⁰ Atlantic & Pacific Tel. Co. v. Union Pac. Ry. Co., 1 McCrary 188,

1 Fed. 745. See Jenson v. Toltec Ranch Co., 174 Fed. 86. Compare Morris v. Elyton Land Co., 125 Ala. 263, 28 So. 513: "a court of chancery can and will undo an act which is *ultra vires*, as well as prevent the same by injunction. There is an equity of rescission as well as of prevention." This case may be supported on the ground of a fraud on the minority, rather than *ultra vires*.

⁴¹ Franklin Bank of Cincinnati v. Commercial Bank of Cincinnati, 36 Ohio St. 350, 38 Am. St. Rep. 594; Milbank v. New York, L. E. & W. R. Co., 64 How. Pr. (N. Y.) 20; Coler v. Tacoma Ry. & Power Co., 65 N. J. Eq. 347, 54 Atl. 413, 103 Am. St. Rep. 786; Parsons v. Tacoma Smelting & Refining Co., 25 Wash. 492, 508, 65 Pac. 765.

thus be deprived of certain effects. But, as the transfer is executed, the corporation acquires title to the stock with the rights and duties usually incident to ownership, so as to be able to sell the same, and receive dividends, and many become liable under a statute to contribute as a stockholder to payment of the debts of the other corporation.⁴² On the latter point, however, the decisions are conflicting.⁴³ It may well be asked whether a corporation which has the benefits of ownership or membership should be allowed to escape the liabilities. The statutory liability of a stockholder to creditors is not truly contractual in its nature, but is imposed by law as incident to membership. The corporation should not be permitted to receive dividends upon the shares while the corporation prospers and repudiate the burdens of ownership when it becomes a financial failure.

§ 73. Contracts executory on both sides.

So long as an *ultra vires* contract is wholly executory on both sides, it is generally held unenforceable, and neither party is estopped to deny the power of the corporation to make it. It follows that no action can be based upon such a contract, either by the corporation⁴⁴ or against it.⁴⁵ Where neither party has

⁴² Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co., 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448; Milbank v. New York, L. E. & W. R. Co., 64 How. Pr. (N. Y.) 20; Bigbee & W. R. Packet Co. v. Moore, 121 Ala. 379, 25 So. 602.

⁴³ California Nat. Bank v. Kennedy, 167 U. S. 362, 42 L. Ed. 198, 17 Sup. Ct. 831, rev'g Kennedy v. California Sav. Bank, 101 Cal. 495, 35 Pac. 1039, 40 Am. St. Rep. 69; Converse v. Emerson Talcott & Co., 242 Ill. 619, 90 N. E. 269. Compare Germania Nat. Bank of New Orleans v. Case, 99 U. S. 628, 25 L. Ed. 448; Fidelity Ins. Co. v. German Sav. Bank, 127 Iowa 591, 103 N. W. 958; Hough v. St. Louis Car Co., 182 Mo. App. 718, 165 S. W. 1161; Hunt v. Hauser Malting Co., 90 Minn. 282, 96 N. W. 85; s. c., 95 Minn. 206, 103 N. W. 1032; Security Nat. Bank of Sioux City, Iowa v. St. Croix Co., 117 Wis. 211, 218, 94 N. W. 74; Warren, Executed *ultra vires* transactions, 23 Harvard Law Rev. 495, 510. See 29 Harvard Law Rev. 320.

⁴⁴ Central Transp. Co. v. Pull-

man's Palace Car Co., 139 U. S. 24, 35 L. Ed. 55, 11 Sup. Ct. 478; Day v. Spiral Springs Buggy Co., 57 Mich. 146, 58 Am. St. Rep. 352; National Finance Co. v. Cramer, 156 Minn. 79, 194 N. W. 108; Nassau Bank v. Jones, 95 N. Y. 115, 23 N. W. 628, 47 Am. Rep. 14; Northwestern Union Packet Co. v. Shaw, 37 Wis. 655, 19 Am. Rep. 781.

Where a wholly executory contract is repudiated a few days after the agreement was made, the plaintiff cannot recover for its repudiation. National Finance Co. v. Cramer, 155 Minn. 79, 194 N. W. 108.

⁴⁵ Ashbury Railway Carriage & Iron Co. v. Riche, L. R. 7 H. L. 653; Thomas v. West Jersey R. Co., 101 U. S. 71, 25 L. Ed. 950; Central Transp. Co. v. Pullman's Palace Car Co., 139 U. S. 24, 35 L. Ed. 55, 11 Sup. Ct. 478; McCutcheon v. Merz Capsule Co., 37 U. S. App. 586; Coppin v. Greenlees & Ransom Co., 38 Ohio St. 275, 43 Am. St. Rep. 425; Davis v. Old Colony R. Co., 131 Mass. 258, 41 Am. St. Rep. 221; Northwestern Union Packet Co. v. Shaw, 37 Wis. 655, 19 Am. Rep. 781;

acted upon the contract, the only injustice caused by refusal to enforce it is the loss of prospective profits. The protection of the stockholders may be a sufficient ground to permit the corporation to enjoin the corporate agents from applying the funds to purposes foreign to the authorized business. If the corporation has a defense, the other party also may plead *ultra vires*, for in a bilateral contract there must ordinarily be mutuality of obligation.⁴⁶

It has been urged, however, by certain writers, that the law ought to give remedies for the enforcement of purely executory contracts, in order to insure the parties the actual fruits of their bargains, rather than to allow either party to repudiate them upon discovering the probability of loss. This view seems to have won the approval thus far of only the Kansas court. In *Harris v. Independence Gas Co.*,⁴⁷ the Independence Gas Co. was formed "to dig or mine for natural gas, and sell the same for heat or lighting purposes." It took a lease from Carr granting the right to explore a tract of land for oil or gas. The grantor of the lessor sued to cancel the lease contract so far as it related to oil, on the ground that the corporation lessee had no authority to engage in the oil business. It was declared by the Kansas court that neither party to even an executory contract should be allowed to defeat its enforcement by a plea of *ultra vires*. A stockholder might, however, be able to interfere to protect his rights as such if he had not assented.

In *Mallory v. Hanauer Oil Works*,⁴⁸ on the other hand, an action of unlawful detainer was brought to recover possession of property surrendered to defendants under a partnership agreement. It is held that the oil works might maintain the action to recover its property from the committee which represented the partner-

Downing v. Mt. Washington Road Co., 40 N. H. 230; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 1007, 56 Am. St. Rep. 203.

⁴⁶ *Whitney Arms Co. v. Barlow*, 63 N. Y. 62, 20 Am. Rep. 504 (semble); *Nassau Bank v. Jones*, 95 N. Y. 115, 47 Am. Rep. 14; *Jamison v. Citizens Sav. Bank of Jefferson*, 122 N. Y. 135, 25 N. E. 284, 9 L. R. A. 708, 19 Am. St. Rep. 482.

⁴⁷ 76 Kan. 750, 92 Pac. 1123, 13 L. R. A. (N. S.) 1171. It is held that a lessor and the assignee of the lessor who has executed to a corporation an oil and gas lease can-

not sue to cancel the portion of the lease relating to oil on the ground that the gas company has no power to enter into a contract for oil. It was declared *obiter* that neither party to an executory contract should be allowed to defeat its enforcement by the plea of *ultra vires*, but the question can only be raised by a stock holder to protect his rights as such. No other court seems to have gone to this extent as to executory contracts. See *Pepper*, 9 Harvard Law Rev. 255.

⁴⁸ 86 Tenn. 598, 8 S. W. 396.

ship of several corporations engaged in manufacturing cotton seed oil. The contract of partnership was for three years, two of which had expired. It was held that the contract was unexecuted as to the remaining year and that it might be repudiated or rescinded by either party as *ultra vires*, even though it had been partly performed. It was said to be the duty of the company to rescind or abandon the contract as to the part still remaining executory.

As was shown in a former chapter, an association which assumes to exercise corporate powers, and enters into a contract as a corporation, and persons who contract with it as a corporation, are estopped, in an action on the contract, to deny its corporate existence.⁴⁹ This principle, however, does not apply where the question is whether a contract is within the powers conferred upon a corporation by its charter. Every person is commonly said to be chargeable with notice of the powers conferred upon a corporation by its charter or articles of incorporation, and neither the corporation nor the person contracting with it is estopped, merely by reason of entering into the contract, from pleading that it is *ultra vires*.⁵⁰ As we shall presently see, however, a corporation may be estopped to deny its power to enter into a particular contract, where the contract is apparently within its powers, and is rendered *ultra vires* because of extraneous facts peculiarly within the knowledge of the corporation, and not known to the other party.⁵¹ And in a majority of the states, though not in all, an estoppel to set up that a contract is *ultra vires* may arise, either against the corporation or against the other party, where the contract has been performed by one of the parties and the other has received the benefit of such performance.⁵²

When it is said that an executory *ultra vires* contract is "void," the word "void" as often is loosely used. What is meant is that the contract in most circumstances is unenforceable. Under some conditions either party may be estopped to plead "*ultra vires*," and if fully executed the transaction may transfer title and create

⁴⁹ Ante, § 27.

⁵⁰ Day v. Spiral Springs Buggy Co., 57 Mich. 146, 23 N. W. 628, 58 Am. Rep. 352; Nicollet Nat. Bank v. Frisk-Turner Co., 71 Minn. 413, 74 N. W. 160, 70 Am. St. Rep. 334; National Home Building & Loan Ass'n v. Home Sav. Bank, 181 Ill. 35, 54 N. E. 619, 64 L. R. A. 399, 72 Am. Rep. 245; Sturdevant Bros. & Co. v. Farmers' & Merchants' Bank of

Rushville, 69 Neb. 220, 95 N. W. 819. But see Harris v. Independence Gas Co., 76 Kan. 750, 92 Pac. 1123, 13 L. R. A. (N. S.) 1171.

⁵¹ See post, §§ 77, 78, 79. See also, Denver Fire Ins. Co. v. McClelland, 9 Colo. 11, 9 Pac. 771, 59 Am. Rep. 134; 24 Harvard Law Rev. 540-542; notes, L. R. A. 1917A 749, 825, L. R. A. 1917B 821.

⁵² See post, § 74.

rights. It is not devoid of legal consequences. While executory there may be up to a certain point a power to defeat it, which is extinguished on performance by the other party.

§ 74. **Contracts executed on one side.**—In some jurisdictions even where the contract is fully performed on one side, the other party can set up *ultra vires* as a defense to an action on the contract itself, but not to an action for the benefits actually received in quasi-contract. In a majority of jurisdictions the one who has received full performance is said to be “estopped” to raise the defense of *ultra vires* to an action on the contract.

The following case may be supposed.⁵³ The X Transportation Co. is incorporated, for the purpose, as stated in its certificate or articles, “of engaging in the business of transporting persons by means of hacks or other vehicles.” Later the stockholders vote that the directors shall engage also in the business of transporting goods by express wagons or motor trucks. The directors purchase the necessary equipment and by advertising and conduct hold themselves out to the public as engaged in the express and moving business. For some years an extensive express business is carried on in the name of the X Co. and large dividends are paid to the stockholders. A makes a contract with manager of the X Transportation Co. for the sale of a motor truck for use in its express business. Let us suppose that A delivers the truck, but X defends on the ground that making the contract was beyond its powers, and therefore it is not liable. Would it matter if the X Co. refused to accept delivery of the truck in accordance with the terms of the contract?

This case illustrates the distinction between the situation arising from repudiation while the contract is executory, and refusal to pay for an executed consideration. If an *ultra vires* contract is still entirely executory, either the corporation or the other party may repudiate the contract, without liability. No damages will be allowed. If the contract has been only partly executed, and the executory part is divisible, either party may refuse to complete what is still executory on both sides. But where either party has fully performed on his side, can the other set up the defense of *ultra vires*, and retain the benefits of the contract while repudiating its burdens?

⁵³ Compare problem case put by *vires* transactions, 24 Harv. Law Warren, article on executory *ultra* Rev. 534.

There is a direct conflict of opinion as to whether, when an *ultra vires* contract with a corporation has been fully performed on one side, the party on whose side it has been performed may maintain an action against the other on the contract, or whether the sole remedy, if any, is *quasi ex contractu*, in disaffirmance of the contract, to recover money paid under it, or the value of property delivered or services rendered.

Some of the courts, including the House of Lords in England, the Supreme Court of the United States, and the Supreme Courts of Alabama, Massachusetts, Tennessee, and several other states, have held that a contract with a corporation which is beyond its powers, or *ultra vires*, though it may not be otherwise illegal, is absolutely void, on the ground that a corporation, by reason of its limited powers, is incapable of making such a contract; that the fact that the contract has been executed by one of the parties, and the other has thus received the consideration for his or its promise, cannot give the contract any validity; that such performance by one of the parties, and receipt of the consideration by the other, does not estop the latter from setting up that the contract is *ultra vires*, since all persons are chargeable with knowledge of the powers of a corporation; and that no action, therefore, will lie on the contract itself by the party on whose part it has been executed, the only remedy, if there is any remedy at all, being *quasi ex contractu*, in disaffirmance of the contract and on an implied contract, to recover the money paid or loaned, or the value of the property delivered or services rendered under the contract. This doctrine is applied in the jurisdictions both where the contract is fully performed by the corporation and the action is brought by it,⁵⁴ and where it is fully

⁵⁴Central Transp. Co. v. Pullman's Palace Car Co., 139 U. S. 24, 35 L. Ed. 55, 11 Sup. Ct. 478; Pittsburgh, C. & St. L. R. Co. v. Keokuk & H. Bridge Co., 131 U. S. 371, 33 L. Ed. 157, 9 Sup. Ct. 770; Buckeye Marble & Freestone Co. v. Harvey, 92 Tenn. 115, 20 S. W. 427, 18 L. R. A. 252, 36 Am. St. Rep. 71; Brunswick Gas Light Co. v. United Gas, Fuel & Light Co., 85 Me. 532, 27 Atl. 525, 35 Am. St. Rep. 385; Northwestern Union Packet Co. v. Shaw, 37 Wis. 655, 19 Am. St. Rep. 781; Sherwood v. Alvis, 83 Ala. 115, 3 So. 307, 3 Am. St. Rep. 695 (a party to an *ultra vires* contract is

not estopped to defend "either by the fact of contracting, whereby the power to contract is, in a sense admitted or recognized, or by the fact that the fruits or issues of the contract have been received or enjoyed"); Paterson & Edy Lumber Co. v. Bank of Mobile, 203 Ala. 536, 84 So. 721, 10 A. L. R. 1037; Calumet & Chicago Canal & Dock Co. v. Conkling, 273 Ill. 318, 112 N. E. 982, L. R. A. 1917 B 814, 821 note (a loan of \$35,000 by the corporation was held *ultra vires* and void, and the trust deeds to secure it unenforceable. The borrower was not estopped to set up *ultra vires* to de-

performed by the other party and the action is brought against the corporation.⁵⁵

This doctrine, however, is not followed in a majority of jurisdictions. In New York, Pennsylvania, Wisconsin, New Jersey, and many other states it has been held that when a contract with a corporation which is merely *ultra vires*, and not otherwise illegal, has been fully executed by one of the parties, so that other party has received the consideration for his or its promise, either in money, property, or services, the party on whose part the contract has been executed may maintain an action upon it, and the other party cannot defeat the action by pleading that the contract is *ultra vires*. It has been so held both in actions by the corporation,⁵⁶ and in actions by the other party against the corporation.⁵⁷

feat collection of the loan. As Carter, J., dissenting, said the effect was an unjust forfeiture because the corporation had violated some shadowy notion of public policy abandoned in recent cases); National Home Building & Loan Ass'n v. Home Sav. Bank, 181 Ill. 35, 54 N. E. 619, 64 L. R. A. 399, 72 Am. St. Rep. 245; Mercantile Trust Co. of Illinois v. Kastor, 273 Ill. 332, 112 N. E. 988, 33 Yale Law Journal 49, 51. See note L. R. A. 1917 B 334.

⁵⁵ Ashbury Railway Carriage & Iron Co. v. Riche, L. R. 7 H. L. 653; Pearce v. Madison & I. R. Co., 21 How. (U. S.) 441, 16 L. Ed. 184; Davis v. Old Colony R. Co., 131 Mass. 258, 41 Am. St. Rep. 221; Downing v. Mt. Washington Road Co., 40 N. H. 230; Franklin Co. v. Lewiston Institution for Savings, 68 Me. 43, 28 Am. St. Rep. 9; Brunswick Gas Light Co. v. United Gas, Fuel & Light Co., 85 Me. 532, 27 Atl. 525, 35 Am. St. Rep. 385; Miller v. American Mut. Acc. Ins. Co., 92 Tenn. 167, 21 S. W. 39, 20 L. R. A. 765; Chewacla Lime Works v. Dismukes, 87 Ala. 344, 6 So. 122, 5 L. R. A. 100; National Home Building & Loan Ass'n v. Home Sav. Bank, 181 Ill. 35, 54 N. E. 619, 64 L. R. A. 399, 72 Am. St. Rep. 245; Best Brewing Co. v. Klassen, 185 Ill. 37, 57 N. E. 20, 50 L. R. A. 765, 76 Am. St. Rep. 26; Durkee v. People ex rel. Askren, 155 Ill. 354, 40 N. E. 626, 46 Am. St. Rep. 340; Simmons v. Farmers' Union Co-op. Ass'n of Bradshaw, — Neb. —, 208 N. W.

144. Right of recovery upon executed *ultra vires* contract is in *quantum meruit* and depends upon the receipt and retention of benefits. The action is not upon the contract itself.

⁵⁶ Whitney Arms Co. v. Barlow, 63 N. Y. 62, 20 Am. Rep. 504; Bath Gas Light Co. v. Claffy, 151 N. Y. 24, 45 N. E. 390, 36 L. R. A. 664; Day v. Spiral Springs Buggy Co., 57 Mich. 146, 58 Am. St. Rep. 352; Camden & A. R. Co. v. May's Landing & Egg Harbor City R. Co., 48 N. J. Law 530, 7 Atl. 523; Gilbert v. Citizens' Nat. Bank of Chickasha, 61 Okla. 112, 160 Pac. 635, L. R. A. 1917A 740, 749n. A corporation which has received money or property of plaintiff under an *ultra vires* contract is "estopped" from raising the defense of *ultra vires* in an action brought against it. In a New York case it is said: "That kind of plunder which holds on to the property, but pleads the doctrine of *ultra vires* against the obligation to pay for it, has no recognition or support in this state." Seymour v. Spring Forest Cemetery Ass'n, 144 N. Y. 333, 341, 39 N. E. 365, 26 L. R. A. 859; s. c., 157 N. Y. 697, 51 N. E. 1094.

⁵⁷ Boyd v. American Carbon Black Co., 182 Pa. St. 206, 37 Atl. 937; Denver Fire Ins. Co. v. McClelland, 9 Colo. 11, 9 Pac. 771, 59 Am. St. Rep. 134; Carson City Sav. Bank v. Carson City Elevator Co., 90 Mich. 550, 51 N. W. 641, 30 Am. St. Rep. 454; Chapman v. Iron Clad

Suppose that A in good faith makes a contract with corporation B for the sale of land and performs by executing a conveyance. B having accepted the benefits of A's performance, declines to pay or carry out the duty on its part because the contract is *ultra vires*. If A sues B, is the corporation to be permitted to set up this defense? It is held by a majority of courts that a plaintiff who has performed his part of the contract may recover and that the corporation cannot set up *ultra vires* to escape a just claim. In *Denver Fire Ins. Co. v. McCelland*⁵⁸ a fire insurance company issued a policy of insurance against loss of crops by hail and received the premium. The company later sought to escape liability for a loss on the ground that it had no power to insure against loss by hail. The court, however, held the company liable to pay the loss, even though the contract was *ultra vires*. A mere return of the premium would have been a mockery of justice.

These courts proceed on the theory that a contract with a corporation which is merely *ultra vires*, is neither *malum in se* nor *malum prohibitum*, so as to be illegal in the sense of the maxim, *Ex dolo malo non oritur actio*, and that public policy, as well as equity and justice, require that a party who has entered into such a contract with a corporation, and received the benefit of full performance by the corporation, or the corporation after receiving the benefit of performance by the other party, shall be held to be estopped to set up the *ultra vires* character of the contract in order to escape liability upon it. The defense of *ultra vires*, said the New York court, "should not as a general rule prevail, whether interposed for or against a corporation, when it would not advance justice, but on the contrary would accomplish a legal wrong."⁵⁹

Illustrations.—According to this doctrine, it has been held that a person who has purchased and received goods or contracted for

Rheostat Co., 62 N. J. Law 497, 41 Atl. 690; Vought v. Eastern Building & Loan Ass'n, 172 N. Y. 508, 517, 65 N. E. 496, 92 Am. St. Rep. 761; Perkins v. Trinity Realty Co., 49 N. J. Eq. 723, 61 Atl. 167 (*ultra vires* plea not allowed where corporation has received the consideration or where all stockholders have assented. To permit repudiation could serve no useful purpose, protect no legitimate interest, and would merely be available in aid of fraud).

⁵⁸ 9 Colo. 11, 9 Pac. 771, 59 Am. Rep. 134; Minneapolis Fire & Marine Mut. Ins. Co. v. Norman, 74 Ark. 190, 85 S. W. 229, 109 Am. St. Rep. 74, 4 Ann. Cas. 1045. Contra, Miller v. American Mut. Acc. Ins. Co., 92 Tenn. 167, 21 S. W. 39, 20 L. R. A. 765.

⁵⁹ Whitney Arms Co. v. Barlow, 63 N. Y. 62, 20 Am. Rep. 504. See 36 Yale Law Journal 297, 308.

services from a corporation cannot defeat an action by the corporation for the price by setting up that it was *ultra vires* for it to deal in or sell the good, or to render the services. In *Whitney Arms Co. v. Barlow*,⁶⁰ the plaintiff was a corporation organized for the purpose of making munitions and firearms. It entered into a contract to manufacture and deliver a quantity of railroad locks, which was not within the purpose for which the plaintiff was incorporated or incidental thereto. The contract was fully performed by the plaintiff and the buyer had received the full benefit. It was held that the plea of *ultra vires* would not be allowed either for or against the corporation, where it would not advance justice, but would accomplish a legal wrong. A corporation cannot set up the defense of *ultra vires* to defeat an action against it on its promise to pay for goods sold and delivered to it.⁶¹ A person who has borrowed money from a corporation, and given his note or other express promise therefor, cannot defeat an action by the corporation on the note or other promise by setting up that it had no power under its charter to make the loan.⁶² A corporation which has borrowed money without authority, or for use, to the knowledge of the lender, in an *ultra vires* business, and given its note or bonds therefor, or other security, cannot avoid liability on its contract because of the *ultra vires* character of the transaction.⁶³ The fact that a lease of its property by a corporation is *ultra vires* cannot be set up by the lessee, where he has

⁶⁰ 63 N. Y. 62, 20 Am. Rep. 504. See also, *Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co.*, 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448; *Vought v. Eastern Building & Loan Ass'n*, 172 N. Y. 508, 65 N. E. 496, 92 Am. St. Rep. 761. See 3 *Fletcher, Corporations*, sec. 1545, p. 2614.

⁶¹ *Dewey v. Toledo, A. A. & N. M. Ry. Co.*, 91 Mich. 351, 51 N. W. 1063; *Carson City Sav. Bank v. Carson City Elevator Co.*, 90 Mich. 550, 51 N. W. 641, 30 Am. St. Rep. 454; *Wright v. Pipe Line Co.*, 101 Pa. St. 204.

But where a corporation entered into an *ultra vires* contract with a commission merchant and member of the cotton exchange for the purchase and sale of cotton by the latter on its account on speculation and the latter purchased and sold cotton in his own name, without any de-

livery or transfer of title to the corporation, it was held that there was no such executed contract as to estop the corporation from setting up the defense of *ultra vires* in an action against it to recover commissions and for money expended. *Jemison v. Citizens' Sav. Bank of Jefferson*, 122 N. Y. 135, 25 N. E. 264, 9 L. R. A. 708, 19 Am. St. Rep. 482.

⁶² *Bond v. Terrell Cotton & Woolen Mfg. Co.*, 82 Tex. 309, 18 S. W. 691. But compare *Calumet & Chicago Canal & Dock Co. v. Conkling*, 273 Ill. 318, 112 N. E. 982, L. R. A. 1917B 814 note, cited in 54, supra.

⁶³ *Bradley v. Ballard*, 55 Ill. 413, 8 Am. St. Rep. 656; *Manhattan Hardware Co. v. Phalen*, 128 Pa. St. 110, 18 Atl. 428; *Wright v. Hughes*, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412.

occupied the premises under the lease, to defeat an action by the corporation to recover the rent agreed upon for the period of such occupancy.⁶⁴ A corporation which has taken a lease in excess of its powers, and occupied the premises under it, cannot set up its want of power as a defense in an action against it for the rent due.⁶⁵ While a contract of partnership between a corporation and an individual is *ultra vires* as to the corporation, yet if the contract has been executed, and the corporation has received the benefit of the same, it will be required in equity to account to the other party for what is due him under the contract.⁶⁶ A corporation cannot escape liability on a contract of guaranty or suretyship, after receiving the benefit of the contract, by setting up that it was *ultra vires*.⁶⁷

The doctrine of estoppel is generally applied only in instances where the fruits of the *ultra vires* contract have inured to the benefit of the corporation and it has not been applied in instances where the benefit of performance has gone to some one else, or where the plaintiff has simply incurred detriment.⁶⁸ This does

⁶⁴ Bath Gas Light Co. v. Claffy, 151 N. Y. 24, 45 N. E. 390, 36 L. R. A. 664.

⁶⁵ Camden & A. R. Co. v. May's Landing & Egg Harbor City R. Co., 48 N. J. Law 530, 7 Atl. 523.

⁶⁶ Boyd v. American Carbon Black Co., 182 Pa. St. 206, 37 Atl. 937; Page-Dressler Co. v. Meader, 118 Ore. 359, 244 Pac. 308.

⁶⁷ Arkansas Val. Town & Land Co. v. Lincoln, 56 Kan. 145, 42 Pac. 706; Crowder State Bank v. Aetna Powder Co., 41 Okla. 394, 138 Pac. 392, L. R. A. 1917A 1021. See Citizens Central Nat. Bank of New York v. Appleton, 216 U. S. 196, 202, 54 L. Ed. 443, 30 Sup. Ct. 364, 365.

Public policy demands honesty and fair dealing on the part of corporations, and this includes banks. Creditor's Claim & Adjustment Co. v. Northwest Loan & Trust Co., 81 Wash. 247, 142 Pac. 670, L. R. A. 1917A 737, Ann. Cas. 1916D 551.

⁶⁸ Nowell v. Equitable Trust Co., 249 Mass. 585, 144 N. E. 749; Sturdevant Bros. & Co. v. Farmers' & Merchants' Bank of Rushville, 62 Neb. 472, 87 N. W. 156, aff'd on rehearing 69 Neb. 220, 95 N. W. 819; Franklin Co. v. Lewiston Insti-

tution for Savings, 68 Me. 43, 28 Am. Rep. 9. But see Kanneberg v. Evangelical Creed Congregation, 146 Wis. 610, 618, 131 N. W. 353, 39 L. R. A. (N. S.) 138, Ann. Cas. 1912 C 376.

In Nowell v. Equitable Trust Co., 249 Mass. 585, 144 N. E. 749, plaintiff fully performed an agreement on the faith of a guaranty by defendant corporation. It was held that the defense of *ultra vires* could be set up against any recovery on the contract of guaranty, which was *ultra vires* a trust company. A different question would be presented if the fruits of the contract had inured to the benefit of the corporation setting up *ultra vires*. See 3 Wisconsin Law Rev. 240 note; Harvard Law Rev. 522. But see United States Fidelity & Guaranty Co. v. Cascade Const. Co., 106 Wash. 478, 180 Pac. 463, the defense of *ultra vires* will not be allowed, even where no benefit was actually received by defendant corporation where other party has been induced to act to its detriment, and where honesty and fair dealing demand enforcement of the contract.

not seem a logical limitation, unless the basis of the doctrine as some contend is really quasi-contractual.

§ 75. Part performance.—Where a continuing *ultra vires* contract is only partly performed, the unexecuted part is treated as executory and is not ordinarily enforced, unless the parties cannot be restored to status quo. Rescission and restitution will normally be granted in disaffirmance of a partly executed contract, unless it is divisible or severable.

Part performance.—The fact that an *ultra vires* contract which is executory on both sides has been partly performed will not according to most authorities entitle either party to maintain an action against the other to compel performance of the residue, or to recover damages for failure to perform.⁶⁹ Where the unexecuted part is severable from the rest, the contract as to that part is treated as wholly executory. It should be otherwise if the contract is entire.⁷⁰ Suppose A contracts with B, an automobile manufacturing company, to furnish B one thousand steel rails for some *ultra vires* use. If A furnishes B with one hundred steel rails and then refuses to furnish any more, B, the corporation, could not compel A to complete his contract, because it is as to B purely executory. Nor could A recover damages against B if B refused to receive further deliveries under the contract, because except as to the part performance it remains executory on both sides, and in general the only hardship to either is the loss of prospective profits.

In a New York case a savings bank and trust corporation undertook, *ultra vires*, to engage in purchasing and selling cotton for future delivery, and employed the plaintiffs, who were commission merchants and members of the cotton exchange, to act for them. The plaintiffs made purchases and sales in their own names, and afterwards brought an action against the corporation to re-

⁶⁹ Ashbury Railway Carriage & Iron Co. v. Riche, L. R. 7 H. L. 653; Thomas v. West Jersey R. Co., 101 U. S. 71, 25 L. Ed. 950; Day v. Spiral Springs Buggy Co., 57 Mich. 146, 28 N. W. 628, 58 Am. Rep. 352; Mallory v. Hanaur Oil Works, 86 Tenn. 598, 8 S. W. 396. And see McCutcheon v. Merz Capsule Co., 37 U. S. App. 586; Memphis & Charleston R. Co. v. Grayson, 88 Ala. 572, 7 So. 122, 16 Am. St. Rep. 69; Greenville Compress & Warehouse Co. v.

Planters' Compress & Warehouse Co., 70 Miss. 669, 13 So. 879, 35 Am. St. Rep. 681.

⁷⁰ Vermont Farm Machinery Co. v. De Sota Co-op. Creamery Co., 145 Iowa 491, 122 N. W. 930. Corporation which had received and paid for one of the articles which it had agreed to purchase could not raise defense of *ultra vires*. Contract was entire and defendant had received part of the benefits under it.

cover commissions and for money expended. It was held that, as there had been no delivery of any cotton or property of any kind, nor the transfer of the title to any property to the corporation, the contract was executory, and that the action, therefore, could not be maintained.⁷¹

In *Day v. Spiral Springs Buggy Co.*,⁷² plaintiff contracted to sell to the defendant corporation certain excelsior, not to be used by defendant in its authorized business, as plaintiff well knew, but to be resold by it on speculation. After delivering a considerable quantity, the plaintiff refused to deliver more, and the defendant refused to pay for what had been delivered unless the whole amount was delivered as agreed, as the price had gone up. It was held that the plaintiff was entitled to recover for the excelsior actually delivered although the contract was *ultra vires*, but defendant could not recoup the damages arising from the failure to complete performance by delivering the balance. Cooley, C. J., said: "Defendant will lose nothing but the anticipated profits on the remainder, if the contract is not enforced in its favor. Those profits it had no right at any time to count upon; and in contemplation of law, there can be no injustice in depriving it of profits which the law could not permit it to bargain for. No valid ground of estoppel is therefore found to exist in the case."

Should the plaintiff's right to recover on the *ultra vires* contract be confined to cases where he has completely performed on his part, and should his relief on a contract partially performed by him be merely quasi-contractual? The objection of lack of mutuality and the circumstance that he could not be compelled to complete may be deemed sufficient reasons to deny recovery on a partially performed contract, but his measure of recovery should be rather on a contract implied in fact for the value of what he has done than for benefits bestowed. Suppose that A has in good faith made a contract with the B. Corporation which is *ultra vires* the corporation. A goes to great expense in preparing to perform, but before the B. Co. has actually accepted any performance or benefits under the contract it repudiates its obligation. Can A recover damages for the breach of the executory contract? On

⁷¹ *Jemison v. Citizens' Sav. Bank of Jefferson*, 122 N. Y. 135, 25 N. E. 264, 9 L. R. A. 708, 19 Am. St. Rep. 482. See *Nassau Bank v. Jones*, 95 N. Y. 115, 47 Am. Rep. 14.

⁷² 57 Mich. 146, 23 N. W. 628, 58

Am. Rep. 352: "If the defendant pays for the property received, the parties will have justice meted out to them as nearly as is now possible."

principle the answer is that if A has changed his position to his detriment in reliance on the contract, the defendant should be liable regardless of the receipt of any benefit.

In a New Jersey case, in which it was held that an action would lie against a corporation for rent due under an *ultra vires* lease, it was said by Judge Van Syckel: "In the conflict of judicial decision on this subject, this court may adopt and should adopt the rule which will produce the best results in the administration of justice. In my judgment the true rule is that when the transaction is complete and the party seeking relief has performed on his part, the plea of *ultra vires* by the corporation, which has acquiesced in it, is inadmissible in an action brought against it for not performing its side of the contract, in all those instances where the party who has performed cannot, upon rescission, be restored to his former status. . . . The underlying principle is that the corporation cannot set up its own infirmity when it is unconscionable to do so. The law forbids the defense on account of the flagrant injustice which would otherwise be done. The question of corporate power is not entertained. To enable recompense to be had to this extent, the contracts are respected, not that they rest in authority, but because good conscience requires it."⁷³

In *Mutual Life Ins. Co. v. Stephens*,⁷⁴ plaintiff, an insurance company, was the assignee of a lease giving an option to the lessee to purchase at a value to be fixed by appraisers. The company sued for specific performance and the defendants set up *ultra vires*. Assuming that the acquisition of the lease was *ultra vires*, because not necessary for the convenient transaction of plaintiff's business, it was held that defendants could not refuse to perform the option because the plaintiff may have exceeded its corporate powers. The question was whether the court would aid the corporation to acquire the fee. If the agreement were wholly executory, the answer would be in the negative. But it had been so far executed that it would be impossible to restore the parties to

⁷³ Camden & A. R. Co. v. May's Landing & Egg Harbor City R. Co., 48 N. J. Law 530, 7 Atl. 523. See also, Denver Fire Ins. Co. v. McClelland, 9 Colo. 11, 9 Pac. 771, 59 Am. Rep. 134. See note in L. R. A. 1917 A 749, 856, Rationale of the doctrine that a corporation which has received the benefits of an *ultra vires* contract cannot resist an ac-

tion brought to enforce it. The doctrine is variously based on: (1) estoppel; (2) public policy; (3) the promotion of justice; (4) capacity to exceed statutory powers, do wrong and incur liability. See Parks, Missouri Bulletin, Law Series, No. 26, pp. 7, 8, 9.

⁷⁴ 214 N. Y. 488, 108 N. E. 856, L. R. A. 1917C 809.

their original situation. Improvements had been made on the faith of the agreement and the plaintiff would presumably lose the value of its investment, unless the option were enforced. The defendants could not refuse to perform their part, certainly not without first offering to pay the value of the improvements. As a rule, however, where a contract has been only partially performed by the plaintiff, the courts refuse to allow him damages for the defendant's repudiation of the executory portion of the contract.⁷⁵ There has been no benefit received by the defendant as to this part, though the plaintiff may have made preparations to perform and changed his position in reliance on the contract. On principle the result should be the same if the plaintiff has suffered a detriment and cannot be placed in *statu quo*, as if the defendant had received and retained the benefit of performance.

Rescission and restitution.—The idea that *ultra vires* contracts and leases are illegal has led some courts even to deny relief by way of rescission and recovering what has been parted with under contracts which are still partly executory. This has the practical result of bringing to pass the very thing that the court says the law forbids, and leads to some very inconsistent and absurd results. It was held by the Supreme Court of United States that where an *ultra vires* contract for the sale or lease of property by a corporation has been executed by the delivery of possession, and the parties are *in pari delicto*, the corporation cannot maintain a suit in equity to cancel the conveyance or lease and recover possession of the property, but the court will leave the parties in the position in which they have placed themselves.^{75a} Where a railroad company leased all its property to another for 999 years, the Supreme Court held that the lease was beyond the corporate powers and void. The lessee paid the rent for some 17 years, and the then lessor sued to have the lease cancelled as *ultra vires*. The Supreme Court held that the parties were in equal fault, that the invalidity of the lease was apparent upon its face, that the lease had been fully executed by the lessor, and refused to cancel the lease. The lease had been fully executed by

⁷⁵ Mallory v. Hanaur Oil-Works, 86 Tenn. 598, 8 S. W. 396; Bowman Dairy Co. v. Mooney, 41 Mo. App. 665.

^{75a} St. Louis, V. & T. H. R. Co. v. Terre Haute & I. R. Co., 145 U. S. 393, 36 L. Ed. 738, 12 Sup. Ct. 953. Compare Cleveland, C., C. & St. L.

Ry. Co. v. Hirsch, 204 Fed. 849. Plaintiff corporation not precluded from suit to cancel lease by being *in pari delicto*, the lease as to renewal being executory and its continuance contrary to public policy. The lease was illegal as involving rebating.

the plaintiff by the actual transfer of possession of the property, and the defendant had not repudiated or abandoned the contract, but had paid rent for 17 years.^{75b}

In *McCutchen v. Merz Capsule Co.*,^{75c} however, several manufacturing corporation and partnerships entered into an *ultra vires* agreement for the combination and consolidation of their several properties and business interests by the organization of a new corporation, the stock in which was to be divided between them, and to which they were to convey their machinery and other property and receive in payment bonds secured by a mortgage. After the new corporation was formed and its stock was divided between the parties to the agreement, and bills of sale and conveyances executed by them to it, but before the new corporation had executed the bonds and mortgage, one of the corporations, being still in possession of its property, repudiated the agreement, and brought a suit to cancel the same and the conveyance and bills of sale executed by it, and to enjoin the new corporation and its officers and agents from forcibly taking possession of its property under the same. Under this condition of things, it was held that, as the agreement had not been fully executed, the relief prayed for should be granted.

§ 76. **Obligation to restore benefits received under *ultra vires* contract.**—In general neither party to an *ultra vires* contract, even if it is regarded as void, can retain what he has received under it without compensation. But in England and a few American states there is no quasi-contractual liability unless the money or property received is applied to legitimate corporate purposes, such as the payment of intra vires debts.

It is a general principle, recognized both in equity and at law, that, when a corporation repudiates an *ultra vires* contract into which it has entered, there is an obligation to restore what it has received under the contract. And the same is true with respect

^{75b} *St. Louis, V. & T. H. R. Co. v. Terre Haute & I. R. Co.*, 145 U. S. 393, 36 L. Ed. 738, 748, 12 Sup. Ct. 953. Suppose the defendant, the lessee, had repudiated, and the plaintiff had sued for rent earned but not paid! The Supreme Court would probably not have allowed recovery of rent. See *Central Transp. Co. v. Pullman's Palace Car Co.*, 171 U. S. 138, 43 L. Ed. 108, 18 Sup. Ct. 808; *C. B.*, p. 378; 3 *Fletcher, Corpora-*

rations, secs. 1587, 1609; 32 *Am. Law Reg.* 36; 23 *Harvard Law Rev.* 627; 43 *Am. Law Reg.* 296, 312; 8 *Yale Law Journal* 24.

^{75c} 71 *Fed.* 787, 31 *L. R. A.* 415. See also, *Mallory v. Hanaur Oil Works*, 86 *Tenn.* 598, 8 *S. W.* 396; *Memphis & Charleston R. Co. v. Grayson*, 88 *Ala.* 572, 7 *So.* 122, 16 *Am. St. Rep.* 69; *Cleveland, C. C. & St. L. Ry. Co. v. Hirsch*, 204 *Fed.* 849.

to the other party to an *ultra vires* contract. The doctrine prevails in the federal courts and those which follow the federal rule, that no recovery can be had on the contract itself even after it has been fully executed upon one side. "However the contractual power of a corporation may be limited under its charter," said the New Hampshire court, "there is no limitation of its power to make restitution to the other party whose money or property it has obtained through an unauthorized contract; nor, as a corporation, is it exempted from the common obligation to do justice which binds individuals, for this duty rests upon all persons alike, whether natural or artificial."⁷⁶ An action on implied contract for money had and received, or for the value of the property or services, is in disaffirmance of the *ultra vires* contract, and not to enforce the same as an action would be to recover in damages the value or equivalent of the promised performance.⁷⁷

Illustrations.—Thus, if a corporation enters into a contract which is merely *ultra vires*, and not immoral nor contrary to any express prohibition, and performs services or delivers goods or conveys land under the contract, the other party cannot set up the *ultra vires* character of the transaction to defeat an action by the corporation to recover the value of the services or of the land or goods, even in those jurisdictions in which no action can be

⁷⁶ Manchester & L. R. R. Co. v. Concord R. R. Co., 66 N. H. 100, 20 Atl. 383, 9 L. R. A. 689, 49 Am. St. Rep. 582. See also, Morville v. American Tract Soc., 123 Mass. 129, 25 Am. Rep. 40; Northwestern Union Packet Co. v. Shaw, 37 Wis. 655, 19 Am. Rep. 781; Rankin v. Emigh, 218 U. S. 27, 35, 54 L. Ed. 915, 921, 30 Sup. Ct. 672; First Nat. Bank of Aiken v. J. L. Mott Iron Works, 258 U. S. 240, 66 L. Ed. 593, 42 Sup. Ct. 286 (whether the contract is valid or not, a guarantor is liable for proceeds coming to his hands upon the inducement of the contract).

⁷⁷ Morville v. American Tract Soc., 123 Mass. 129, 25 Am. Rep. 40; Northwestern Union Packet Co. v. Shaw, 37 Wis. 655, 19 Am. Rep. 781; Day v. Spiral Springs Buggy Co., 57 Mich. 146, 23 N. W. 628, 58 Am. Rep. 352; Slater Woollen Co. v. Lamb, 143 Mass. 420, 9 N. E. 823; Crowder State Bank v. Aetna Powder Co., 41 Okla. 394, 138 Pac. 392,

L. R. A. 1917A 1021, 1026 note. Remedies which the parties to an *ultra vires* contract are entitled to pursue apart from an action on the contract itself. See Central Transp. Co. v. Pullman's Palace Car Co., 139 U. S. 24, 60, 35 L. Ed. 55, 60, 11 Sup. Ct. 478. Luhrig Collieries Co. v. Interstate Coal & Dock Co., 281 Fed. 265.

A was indebted to the B National Bank in the sum of \$10,000. At the request of B, the C bank made a loan of \$12,000 to A, upon the faith of a guaranty by B. Under a previous agreement A paid over \$10,000 of the loan so obtained to B. A defaults. C sues B on its guaranty and B pleads *ultra vires*. The Supreme Court allowed C to recover \$10,000 as neither party to an *ultra vires* contract may retain what he has received under it without compensation. Citizens' Central Nat. Bank of New York v. Appleton, 216 U. S. 196, 54 L. Ed. 443, 30 Sup. Ct. 364.

maintained on the contract. As he has had the benefit of the transaction, the law will imply or create a contractual or quasi-contractual obligation to pay for the value received.⁷⁸ In like manner, when a corporation is sued *quasi ex contractu* for the value of goods or land purchased and received by it, or for the value of services rendered for it under a contract, it cannot defeat a recovery by setting up that the contract was *ultra vires*.⁷⁹ This principle also applies to an action *quasi ex contractu* to recover for use and occupation under an *ultra vires* lease, even in those jurisdictions which do not allow an action by the lessor to recover the rent on the contract of lease itself and do not recognize an estoppel by the receipt of the benefits to plead *ultra vires*.⁸⁰

In some jurisdictions where money is borrowed or lent by a corporation in excess of its powers the contract is regarded as wholly void. But the courts will usually give relief to prevent injustice by an action for money had and received or money lent independently of the contract. The party benefited will not be permitted to retain the fruits of the transaction and at the same time deny its validity.⁸¹ The practical effect of course is usually

⁷⁸ Slater Woollen Co. v. Lamb, 143 Mass. 420, 9 N. E. 823. And see Brunswick Gas Light Co. v. United Gas, Fuel & Light Co., 85 Me. 532, 27 Atl. 525, 35 Am. St. Rep. 385. Contra, Valley Ry. Co. v. Lake Erie Iron Co., 46 Ohio St. 44, 18 N. E. 486, 1 L. R. A. 412; Grand Lodge v. Waddill, 36 Ala. 313, 319; Wiley Fertilizer Co. v. Carroll, 202 Ala. 335, 80 So. 417.

⁷⁹ Day v. Spiral Springs Buggy Co., 57 Mich. 146, 23 N. W. 628, 58 Am. Rep. 352; Moore v. Swanton Tanning Co., 60 Vt. 459, 15 Atl. 114.

⁸⁰ See Manchester & Lawrence R. Co. v. Concord R. Co., 66 N. H. 100, 20 Atl. 383, 9 L. R. A. 689, 49 Am. St. Rep. 582; Brunswick Gas Light Co. v. United Gas, Fuel & Light Co., 85 Me. 532, 27 Atl. 525, 35 Am. St. Rep. 385. *Ultra vires* leases, Hariman, 14 Harvard Law Rev. 332.

⁸¹ Leigh v. American Brake-Beam Co., 205 Ill. 147, 68 N. E. 713; Morville v. American Tract Soc., 123 Mass. 129, 25 Am. Rep. 40; Allen v. Freedman's Savings & Trust Co., 14 Fla. 418. Contra, Grand Lodge of Alabama v. Waddill, 36 Ala. 313.

Some courts hold that if money is borrowed by a corporation without authority, it is not liable on its contract to pay the same, but is liable, both at law and in equity, to the extent to which the money has been applied to legitimate corporate purposes. In re National Permanent Ben. Bldg. Soc., 5 Ch. App. 309; Wenlock v. River Dee Co., 19 Q. B. Div. 155; In re Cork & Youghal Ry. Co., 4 Ch. App. 748; Sinclair v. Brougham, [1914] A. C. 398; Jones v. Guaranty & Indemnity Co., 101 U. S. 622, 25 L. Ed. 1030; Wiley Fertilizer Co. v. Carroll, 202 Ala. 335, 80 So. 417 (bank held not liable for fertilizer which it received under *ultra vires* contract, if not used to carry on lawful business of bank); Standard Savings & Loan Ass'n v. Aldrich, 163 Fed. 216, 20 L. R. A. (N. S.) 393 (lender can recover only to the extent that he can show corporation has been benefited, where he lends with knowledge of intention to use it for *ultra vires* purpose, such as to pay withdrawing members of building and loan association).

much the same as enforcing the contract itself, except where some security is denied enforcement.⁸²

Subrogation.—In England it has been held in several cases that if a corporation borrows money when it has no power to do so, either because its nature is such that it cannot borrow at all, or because the amount which it is authorized to borrow is limited by its charter, and the money so borrowed is applied to the payment of valid debts of the corporation, whether contracted before or after the loan, the lender, or the holder of bonds issued for the loan, may recover from the corporation to the extent to which the money has been so applied. To this extent he is merely subrogated in equity to the rights of the creditors who have been paid, and there is no increase in the indebtedness of the corporation.⁸³ In *Wenlock v. River Dee Co.*,⁸⁴ one question was whether there could be recovery of moneys advanced, which had been applied in payment of debts of the company, which arose subsequently to the loans. It was *held* that when a company, which has exhausted its borrowing powers, purports to borrow further money, the loan contract is void; but the company is liable to refund in equity for money improperly borrowed, which has been applied in discharging debts which could have been enforced against it, whether incurred before or after the loan.

It was suggested by Fry, L. J., that this equity of the lender is based on the fiction of subrogation, viz., that the law looks at it as if the quasi lender had paid the debt of the company to its creditor and had taken an assignment of the claim from the creditor. In *re Wrexham, Mold, etc., Ry. Co.*,⁸⁵ the question was presented

⁸² *Calumet & Chicago Canal & Dock Co. v. Conkling*, 273 Ill. 318, 112 N. E. 982, L. R. A. 1917B 814, 821n. One borrowing money from a corporation is not estopped to set up *ultra vires* to defeat foreclosure of trust deeds. See Gilbert, 1 Ill. Law Bul. 42.

⁸³ In *re Birkbeck, etc., Soc.*, [1912] L. R. 2 Ch. D. 183; *Sinclair v. Brougham*, [1914] A. C. 398, 412. See L. R. A. 1917 A 802, 812, 1026, 1032, 1034; In *re National Permanent Ben. Bldg. Soc.*, L. H. 5 Ch. App. 309; *Baroness Wenlock v. River Dee Co.*, L. R. 19 Q. B. Div. 155, L. R. 36 Ch. Div. 674, 10 A. C. 354; *Blackburn Bldg. Soc. v. Canliffe, etc., Co.*, 22 Ch. Div. 61, 71. See *Bannatyne v. MacIver*, [1906] 1 K. B. 103,

⁸⁴ L. R. 19 Q. B. Div. 153, L. H. 36 Ch. Div. 674, 10 A. C. 354. This case does not stand as an authority for the doctrine that a corporation which has accepted the benefits of a contract is estopped from setting up a plea of *ultra vires*. See *Sinclair v. Brougham*, [1914] A. C. 412, 440; 1 *Lindley Companies* (6th Ed.), pp. 286, 294; L. R. A. 1917 A 804, 806, 810, 1029, 1032. There is no claim *in personam* based on the circumstance that the defendant has been unjustly enriched at the expense of the plaintiff by a transaction which is *ultra vires*. This would be to validate the transaction as a contract to repay money loaned.

⁸⁵ L. R. 1 Ch. 440. Query: What difference does it make whether the

whether the subrogation theory would be carried so far as to allow the lender of money to a corporation whose borrowing powers were exhausted, to claim the benefit of securities or of the priority of the creditor whose debt is paid off. It was *held* "No"; that the quasi-lender would have no greater rights than if the advance were valid. Such an application of the subrogation fiction would be unjust to other creditors. The bank was only entitled to a kind of quasi-contractual claim so far as the money had been applied in the discharge of legal debts, but the lender is not subrogated to any securities or priorities of the creditors who are paid by means of his loan. In a few American jurisdictions a quasi-contractual claim arises only in so far as the money has been applied to the payment of valid debts of the corporation, or the goods have been used for legitimate corporate purposes.⁸⁶

Accounting in equity.—When, under an *ultra vires* contract with a corporation, one of the parties has received money or property to which the other is equitably entitled, a court of equity, if it has jurisdiction in the particular case, will compel an accounting. Thus, where railroad companies entered into a pooling contract, and the contract was carried out, and the profits therefrom collected and held by the receiver of one of the companies, a court of equity compelled him to account to the other company for its share.⁸⁷ Where a railroad company uses the roadbed, rolling stock, and equipment of another company under an *ultra vires* lease or other contract, it cannot defeat a suit in equity for an accounting and a return of the property on the ground that the contract was *ultra vires*.⁸⁸ The right to recover property delivered

company has the money or its proceeds on hand, or whether it has used it to pay prior or subsequently contracted debts? The true basis is quasi contract, or benefit received. The obligation should arise when the money is received, and not merely when the debt is paid. If no obligation to the lender arises when the company receives the money, why should one arise to him when the company contracts a debt to a third party by buying goods and then uses the money to pay for it? Should not there be a quasi-contractual obligation whenever the plaintiff can show that the company's assets are greater, or its liabilities are less by virtue of the money borrowed? See

Citizens' Cent. Nat. Bank of New York v. Appleton, 216 U. S. 196, 54 L. Ed. 443, 30 Sup. Ct. 364; Machen, Corporations, sec. 1705.

⁸⁶ In Wiley Fertilizer Co. v. Carroll, 202 Ala. 335, 80 So. 417, it is held that a bank is not liable in quasi contract for fertilizer or goods delivered to it under an *ultra vires* contract, unless the property has been beneficially applied to authorized objects or purposes. See Standard Savings & Loan Ass'n v. Aldrich, 163 Fed. 216, 20 L. R. A. (N. S.) 393.

⁸⁷ Central Trust Co. v. Ohio Cent. R. Co., 23 Fed. 306.

⁸⁸ Manchester & L. R. R. Co. v. Concord R. Co., 66 N. H. 100, 20 Atl.

under an *ultra vires* lease is allowed upon disaffirmance.⁸⁹ The same rule applies where a corporation enters into an *ultra vires* partnership agreement with an individual or another corporation. Either party may be compelled to account to the other for his or its share of the profits.⁹⁰

§ 77. Contracts apparently authorized.

- (1) A corporation is liable on a contract which is apparently within its powers, although it is rendered *ultra vires* by reason of extrinsic facts, if such facts were not within the knowledge of the other party.
- (2) If a corporation has the power, under some circumstances, to become a party to negotiable instruments, and it does so for an unauthorized purpose, it cannot set up the defense of *ultra vires* as against a bona fide purchaser for value. This rule applies to accommodation paper.

Estoppel to plead want of power.—When want of power on the part of a corporation to enter into a particular contract is apparent, upon a mere comparison of the contract with the charter of the corporation, the person dealing with the corporation is generally held to be chargeable with notice that the contract is *ultra vires*. And in such a case, therefore, the corporation cannot be held liable on the contract merely because the other party acted in good faith, and did not in fact know that the contract was unauthorized.⁹¹ An estoppel to plead *ultra vires* may arise, however, when a contract is apparently within the charter powers of the corporation, and the other party is ignorant of extrinsic facts rendering it *ultra vires*. In other words, "when the transaction is not the exercise of a power not conferred on a corporation, but the abuse of a general power in a particular instance, the abuse not being known to the other contracting party, the doctrine of *ultra vires* does not apply."⁹² An accommodation indorsement of negotiable

383, 9 L. R. A. 689, 49 Am. St. Rep. 582.

⁸⁹ Pullman's Palace Car Co. v. Central Transp. Co., 171 U. S. 138, 43 L. Ed. 108, 18 Sup. Ct. 808; Rankin v. Emigh, 218 U. S. 27, 35, 54 L. Ed. 915, 921, 30 Sup. Ct. 672. See Harriman, 14 Harv. Law Rev. 332, 339; Pepper, 8 Yale Law Journal 24.

⁹⁰ Boyd v. American Carbon Black Co., 182 Pa. St. 206, 37 Atl. 937.

⁹¹ Monument Nat. Bank v. Globe Works, 101 Mass. 57, 3 Am. Rep.

322. And see East Anglian Ry. Co. v. Eastern Counties Ry. Co., 11 C. B. 775; Davis v. Old Colony R. Co., 131 Mass. 258, 41 Am. Rep. 221; Kraniger v. People's Bldg. Soc., 60 Minn. 94, 61 N. W. 904; Lucas v. White Line Transfer Co., 70 Iowa 541, 30 N. W. 771, 59 Am. St. Rep. 449.

⁹² Monument Nat. Bank v. Globe Works, 101 Mass. 57, 3 Am. Rep. 322; Lucas v. White Line Transfer Co., 70 Iowa 541, 30 N. W. 771, 59

paper is not something outside of the powers conferred upon the corporation, but is the abuse or excessive exercise of the corporate power to make and indorse commercial paper. The question of power depends upon the existence of certain facts resting within the knowledge of the corporate officers, and the corporation may be responsible for the unauthorized acts of its agents apparently clothed with its authority. Where the party who deals with the corporation would be justified in believing that the corporation had power to enter into the contract, even if he should read the charter or articles, he should be protected as to the contracts apparently within the powers of the corporation, whether or not the contract has been fully executed on one side.

Illustrations.—This principle applies, for example, when a corporation executes a note or accepts a bill, or indorses a bill or note, for the mere accommodation of another, and a purchaser who is ignorant of the fact that it is merely accommodation paper takes the note or acceptance.⁹³ A corporation cannot avoid liability on a negotiable bill, note, or bond in the hands of a *bona fide* purchaser by setting up the defense that it is *ultra vires* because it was issued in violation of a provision limiting the amount of indebtedness which the corporation might incur,⁹⁴ or because it was issued for a purpose for which the corporation was not authorized by its charter to issue it.⁹⁵ Estoppel arises where a corporation pur-

Am. Rep. 449; *Miner's Ditch Co. v. Tellerbach*, 37 Cal. 543, 99 Am. Dec. 30; *James Eva Estate Co. v. Mecca Co.*, 40 Cal. App. 515, 181 Pac. 415; *Farmers' Nat. Bank of Valparaiso, Ind. v. Sutton Mfg. Co.*, 52 Fed. 191, 17 L. R. A. 595.

⁹³ *Monument Nat. Bank v. Globe Works*, 101 Mass. 57, 3 Am. Rep. 322; *Credit Co. v. Howe Machine Co.*, 54 Conn. 357, 8 Atl. 472, 1 Am. St. Rep. 123; *Putnam v. Ensign Oil Co.*, 272 Pa. 301, 116 Atl. 285. See *Citizens Nat. Bank of Fernandina v. Florida Tie & Lumber Co.*, 81 Fla. 889, 89 So. 139. See also, L. R. A. 1917 A 776 note.

In *Monument Nat. Bank v. Globe Works*, 101 Mass. 57, 3 Am. Rep. 322, it was held that a manufacturing corporation has no power to issue or indorse negotiable instruments for the mere accommodation of another; but it cannot set up its want of power against the *bona fide*

purchaser for value before maturity, where he takes the note or instrument in ignorance of the fact that it is merely accommodation paper. See also, *Brill Co. v. Norton & T. St. R. Co.*, 189 Mass. 431, 75 N. E. 1090, 2 L. R. A. (N. S.) 525. The corporation may, however, set up the defense as against a purchaser with notice of the *ultra vires* character of the instrument.

⁹⁴ *Wood v. Corry Water-Works Co.*, 44 Fed. 146, 12 L. R. A. 168; *Auerbach v. Le Sueur Mill Co.*, 28 Minn. 291, 9 N. W. 799, 41 Am. Rep. 285.

⁹⁵ *Monument Nat. Bank v. Globe Works*, 101 Mass. 57, 3 Am. Rep. 322; *Wright v. Pipe Line Co.*, 101 Pa. St. 204, 4 Ky. L. Rep. 738, 4 Am. Rep. 701; *National Bank of Republic v. Young*, 41 N. J. Eq. 531, 7 Atl. 488; *Credit Co. v. Howe Machine Co.*, 54 Conn. 357, 8 Atl. 472, 1 Am. St. Rep. 123.

chases property which it has apparent authority to purchase, or borrows money which it has apparent authority to borrow, but, without the knowledge of the other party, does so for an unauthorized purpose, or exceeds the limit of indebtedness fixed by its charter or by statute.⁹⁶ Is a person who lends money to a corporation bound to investigate whether the money is borrowed for a proper purpose? A corporation cannot do anything properly except for the purposes of its business, borrowing or anything else; everything else is *ultra vires*. But it is held the lender need not investigate. A corporation, every time it wants to borrow money, cannot be called upon by the lender to expose all its affairs so that the lender can say, "Before I lend you anything I must know why you want the money and how you intend to apply it." That is all matter lying between the shareholders and the directors, who may be liable to the corporation for a wrongful act.⁹⁷ The same should be true of a lending to a company with a limited borrowing power, in excess of the amount authorized. As a check on reckless management, a debt limit is sometimes imposed by the articles, and courts differ as to the validity of debts incurred in excess of the limit. The weight of authority is to the effect that the indebtedness is valid to the extent of the consideration received by the corporation.^{97a} In England, however, no recovery can be had against the corporation except in so far as the money is used in paying off lawful debts. In Kentucky, no recovery can be had to the prejudice of other creditors.

⁹⁶ *Lucas v. White Line Transfer Co.*, 70 Iowa 541, 30 N. W. 771, 59 Am. Rep. 449; *Auerbach v. Le Sueur Mill Co.*, 28 Minn. 291, 9 N. W. 799, 41 Am. Rep. 285; *Grand Valley Water Users' Ass'n v. Zumbunn*, 272 Fed. 943; *In re David Payne & Co., Ltd.*, [1904] 2 Ch. 608 (the lender need not inquire into the purposes to which the money is intended to be applied); *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673, 709, 53 Atl. 842, 853: "Whether an expenditure is *intra vires* or *ultra vires* must in large numbers of instances depend upon the purpose—the actual honest purpose—which the directors have in view."

⁹⁷ Where a corporation with power to borrow money for the purposes of its proper business borrows for some *ultra vires* purpose, the loan

is not thereby invalidated in the absence of knowledge by the lender of the improper purpose of the loan. *In re David Payne & Co., Ltd.*, [1904] 2 Ch. 608. That the loan should be valid in spite of notice, see note 18 *Harvard Law Rev.* 463.

^{97a} *Grand Valley Water Users' Ass'n v. Zumbunn*, 272 Fed. 943 (lender's knowledge that money was to be used for unauthorized purpose does not defeat recovery on note. Notes in excess of debt limit are binding where promisor has received the money). *Op. Kraniger v. People's Bldg. Soc.*, 60 Minn. 94, 61 N. W. 904. See *American Southern Nat. Bank v. Smith*, 170 Ky. 512, 186 S. W. 432, Ann. Cas. 1918B 959, 966n. A bank which lends money to another bank in excess of borrower's charter powers is liable to

§ 78. Abuse of power distinguished from want of power.—The supposed distinction between abuse or excess of a general power as contrasted with entire want of power is of doubtful validity, but may perhaps be explained in terms of ostensible or apparent power on which the person dealing with the corporation is entitled to rely.

Some of the courts, in applying the doctrine of *ultra vires*, have made a distinction between contracts of a corporation which are *merely in excess* of the general powers of the corporation, or abuse of powers, and such as are *entirely beyond* its powers, and have held that no action can be maintained upon a contract falling within the latter class, although it may have been fully performed on one side, while, under such circumstances, an action may be maintained upon a contract falling within the former class. Thus, in a Mississippi case, where a loan was made by a corporation upon a note secured by a mortgage on land, when the corporation was not authorized to make loans except on notes with personal security, it was held that the *mortgage* was valid, and could be enforced, not merely on the ground that the corporation had furnished the consideration, and that the borrower was estopped to set up the defense of *ultra vires*, but on the ground that taking the mortgage was merely an excess of the corporation's general power to make the loan. The court said: "There was a loan irregularly made. The power to loan is conferred; the mode is regulated. If a corporation make a contract altogether outside of the purposes of its creation, it is void, because it has not power over the subject in reference to which it acts. But if it contracts with reference to a subject within its powers, but in doing so exceeds them, the person with whom it deals cannot set up such violation of its franchises to avoid the contract."⁹⁸

In an Illinois case⁹⁹ it is said: "Where a corporation has the general power to possess real estate and a building necessary for

return assets pledged as security to receiver of borrower who represents its creditors.

⁹⁸ Littlewort v. Davis, 50 Miss. 403. See also, Rock River Bank v. Sherwood, 10 Wis. 230; Germantown Farmers' Mutual Ins. Co. v. Dhein, 43 Wis. 420, 28 Am. St. Rep. 549; National Home Building & Loan Ass'n v. Home Sav. Bank, 181 Ill. 35, 54 N. E. 619, 72 Am. St. Rep. 245; Fletcher, Corporations, secs. 1598, 1599, 1600.

James Eva Estate v. Mecca Co., 40 Cal. App. 515, 181 Pac. 415. When the act is one within corporate powers for some purposes or under some conditions, the defense of *ultra vires* is not available, unless it is shown that the person dealing with the corporation had notice of the unauthorized purpose in view.

⁹⁹ McIlvane v. Foreman, 292 Ill. 224, 229, 126 N. E. 749. See 34 Harvard Law Rev. 292. A lease to a corporation was held *ultra vires*

its proper corporate purpose, the state only may raise the question of abuse of such powers; but where the act done by the corporation is beyond its legal powers the act is wholly void and of no legal effect and the legality of the act may be raised by any party affected by it."

Whether such a distinction as this is sound admits of very reasonable doubt. If a corporation is authorized to make a particular contract, and exceeds its power in this respect, it certainly acts without any power over the subject in so far as the excess is concerned. If it is authorized to make loans on personal security only, and it makes a loan on a real-estate mortgage, it certainly acts without power in taking the mortgage. The same is true where a corporation is authorized to borrow money or buy goods for the purposes of its legitimate business, and it borrows money or buys goods to be used in a business which it has no power to carry on. It may well be in such cases that the party—the corporation or the other party, as the case may be—should not be permitted to escape liability on the contract after receiving the benefit of it, as is held by many of the courts; but it is more reasonable to allow an action in such cases, on the ground that justice requires that the party who has received and retains the benefits of the contract should be held estopped to say that the contract was *ultra vires*, than to attempt to make a distinction, shadowy, to say the least, between want of power on the part of the corporation and mere excess of power,—an attempt which must result, and has resulted, in confusion and conflicting decisions. It seems absurd to say that a corporation which takes a mortgage to secure a loan, when its charter expressly declares that it shall have the power to loan money on personal security only, acts, not without power, but merely in excess of power, in taking the mortgage. Making the loan is within the power of the corporation, but taking the mortgage is as entirely beyond its actual authority as if it were not authorized to make the loan at all.

This distinction, however, suggests that some effect may be given to ostensible authority. *Ultra vires* transactions may be very similar to those authorized by the specified objects, so that even lawyers would differ on the question and only the highest courts could settle the matter. The directors themselves may not suppose

and void, where made as an investment and could be set aside by the lessor after receiving rent for 29 years.

Estoppel to raise defense of *ultra vires*; effect of claimant's ignorance of corporation's abuse of powers. See L. R. A. 1917A 749, 775 note.

that what they are doing is outside the scope of the implied powers. Under these circumstances it would seem that the corporation should be responsible for the acts of its managers *ultra vires*, who are ostensibly authorized to act for it in the apparent scope of its business.

The California court said in *Miners' Ditch Co. v. Zellerbach*:¹⁰⁰ "The officers are appointed by the corporation, and if any loss results to strangers dealing with the corporation from their misrepresentation in matters within the general scope of their duties, it should fall on the corporation, which is responsible for their appointment, rather than upon parties who have no other means of ascertaining the facts, and must rely upon their assurance or not deal with the corporation at all." It is true that the corporation is not necessarily responsible for every act done by an officer in the name of the corporation. The principles of agency apply, and if the person who deals with the officer has no sufficient reason to suppose that the officer was authorized to enter the transaction, he cannot hold the corporation, unless the stockholders have ratified the act in fact or in law by acquiescence in it. The defense is not that it could not contract, but that the corporation did not authorize it.¹⁰¹

The principle of ostensible power has been stated as follows: "If the one who contracts with the corporation knows of the limitations upon the power of the corporation, or if he ought to have known of this limitation, and the stockholder is not assenting, his position is somewhat analogous to that of one who contracts with an agent with knowledge that he is exceeding the limitations upon his authority and he should not be allowed to hold the corporation liable upon the contract. . . . On the other hand, the party who contracts with an agent or a partner who is acting in excess of limitations on his power, but within the range of the power implied from the nature of the business or from custom or usage may hold the principal or partnership liable, provided he does not know of the limitation, for it is not reasonable to charge him with notice. Should not this rule of partnership and agency law be the criterion in corporation law? . . . Persons who con-

¹⁰⁰ 37 Cal. 543, 588, 99 Am. Dec. 30. "When a contract is not on its face necessarily beyond the scope of the powers of the corporation by which it was made, it will, in the absence of proof to the contrary, be presumed to be valid. Corporations

are presumed to contract within their powers." *Ohio & M. Ry. Co. v. McCarthy*, 96 U. S. 258, 267, 24 L. Ed. 693.

¹⁰¹ *Sturdevant Bros. & Co. v. Farmers' & Merchants' Bank*, 69 Neb. 220, 95 N. W. 819.

tract with the corporation ought not at their peril to be required to ascertain the limits of the corporation's power."¹⁰²

§ 79. Constructive notice of charter limitations.—Persons dealing with the managers or representatives of a corporation must in general take notice at their peril of the limitations upon their authority and the power of the corporation imposed by the charter or articles of incorporation, which are required to be kept on record. But this technical doctrine has been criticised and should be restricted to a duty to take reasonable notice of the nature of the corporation and the customary scope of its business.

If a person contracting with a corporation has relied on the corporation's undertaking, and has changed his position to his disadvantage in ignorance of facts which would make the transaction *ultra vires* as to the corporation, can the corporation be heard to assert a want of power to execute the contract? If the contract is one not on its face *ultra vires* under all circumstances, cannot the person dealing with the corporation assume that it was entered into within the authority and power of the corporation in furtherance of its aims and business? The circumstance that stockholders place directors in control of the corporation and that the corporation by its avowed representatives enters upon a transaction as corporate business ought to place the burden upon it of proving notice of want of authority to carry on such business if it seeks to be relieved of liability on the ground of *ultra vires*. The corporate body which installs the managing officers in their positions and holds them out to the public, apparently vested with full authority, ought to bear the responsibility as to the scope of the business.

A person dealing with a corporation is however, held chargeable with notice of its powers and the purposes for which it is formed, and when dealing with its agents or officers is bound to observe the limitations on their power and authority, imposed by the charter, to bind the corporation. As to the constructive notice of limitations of power, such as the debt limit, Mitchell, J., states the general rule in *Kraniger v. People's Building Society*:¹⁰³ "But in the present case the society has received none of the benefits of the loan, and the transaction was one which in and of itself assumed to create an indebtedness on the part of the society in excess of the

¹⁰² Carpenter, 33 Yale Law Journal 49, 65, 66.

¹⁰³ 60 Minn. 94, 61 N. W. 904; *Sturdevant Bros. & Co. v. Farmers'*

& Merchants' Bank, 69 Neb. 220, 95 N. W. 819; *Scott v. Bankers Union*, 73 Kan. 575, 85 Pac. 604.

limit fixed by its articles. The plaintiff was chargeable with notice of this latter fact, for it is a settled rule that a person who deals with a corporation must, at his peril, take notice of its charter or articles of association. It follows, therefore, that, so far as the authority of any agent of a corporation, or even of the board of directors itself, is defined by its charter or articles of association, the scope and extent of their powers must always be considered as disclosed."

It has been well pointed out that this extreme doctrine is neither just nor practical. "If the law does expect and require all who deal with a corporation to be familiar with and understand the charter, the requirement is unreasonable and the expectation is doomed to disappointment. The exigencies of ordinary business alone will often prevent a search of corporate records. . . . Indeed in many cases the search could not be made, if desired."¹⁰⁴ Probably the purpose of the statutes requiring charters to be filed is to afford those desiring to look an opportunity to acquire knowledge, rather than to protect the corporation against abuse of power by corporate officers. Those who deal with corporations in the daily exercise of their assumed powers are as much entitled to protection as stockholders. In *Eastern Counties Ry. Co. v. Hawkes*,¹⁰⁵ Lord St. Leonards said that his disposition was, "to restrain the doctrine of *ultra vires* to clear cases of excess of power, with the knowledge of the other party, express or implied from the nature of the corporation and of the contract entered into." It would seem that the courts ought not to require persons contracting with corporations to ascertain at their peril the line between *intra*

¹⁰⁴ J. L. Parks, *Ultra vires* transactions, Mo. Bulletin, Law series, 25, p. 21; Denver Fire Ins. Co. v. McClelland, 9 Colo. 11, 22, 9 Pac. 771, 59 Am. Rep. 134.

Freeman, in a note in 70 American State Reports 176, says: "A strict adherence to the rule of the law of (constructive) notice must entail endless injustice, not to say involve infinite absurdity. This rule lies at the foundation of the doctrine of *ultra vires* as it was originally conceived."

In *Bissell v. Michigan Southern & N. I. R. Co.*, 22 N. Y. 258, Comstock, Ch. J., says: "A traveler from New York to Mississippi can hardly be

required to furnish himself with the charters of all the railroads on his route, or to study a treatise on the law of corporations." See *City Coal & Ice Co., Inc. v. Union Trust Co.*, 140 Va. 600, 125 S. E. 697 (the technical rule of constructive notice from the charter applies only to parties dealing directly with the corporation, not to an indorsee). See also, notes 10 Cornell Law Quarterly 498; 11 Virginia Law Rev. 406; 9 Minnesota Law Rev. 478; 26 Harvard Law Rev. 540; 24 Harvard Law Rev. 539; 33 Yale Law Journal 49, 61; 36 Yale Law Journal 321.

¹⁰⁵ 5 H. L. Cas. 331, 373.

vires and *ultra vires*, but merely to take reasonable notice of the nature of the corporation and the customary scope of its business.

If a cashier of a bank, for example, is by the corporation held out to the public as authorized to act for the bank, and persons relying on such ostensible authority and the power of the bank to make such contracts, deal with him and change their position to their detriment, the bank may be estopped from pleading either its want of power or the authority of the cashier to bind it. If the contract is part of the ordinary and usual business of the bank then the cashier may have apparent authority as one of the principal executive officers. If there is nothing in the transaction and the nature of the corporation to excite doubt or suspicion on the part of the one dealing with the corporation that the contract was not entered into as part of the ordinary and usual or authorized business of the corporation, then it should be presumed to be within its powers and the burden should be on the corporation to show notice of the lack of authority. But one dealing with a corporation may not presume without inquiry that an officer acting for the corporation is within the scope of his authority regardless of the circumstances. If the transaction is no part of the usual or ordinary business of the corporation, this is a circumstance calling for inquiry as to the power of the corporation to obligate itself in such an undertaking. One in dealing with a bank, for instance, cannot disregard the nature of the business in which the corporation is normally engaged.¹⁰⁶

§ 80. Effect of knowledge that a transaction is *ultra vires*.—If one dealing with a corporation knows or ought to know of the limitations upon its scope of business and the stockholders do not assent, he cannot rely on estoppel or apparent power of the agents of the corporation to bind it. But if the contract is executed by him and the corporation receives the benefits, his knowledge will not be a defense, unless he aids or participates in the *ultra vires* transaction. In tort cases, knowledge of *ultra vires* transaction is no defense.

¹⁰⁶ The execution by the cashier of a bank of a bond as surety in an action between third parties is so much beyond the general scope of the business of such corporation and the authority of the cashier, as to require those dealing with the cor-

poration to see to it that the bank was empowered and the cashier authorized to execute such an undertaking. *Sturdevant Bros. & Co. v. Farmers' & Merchants' Bank*, 69 Neb. 220, 95 N. W. 819.

Suppose that A lends money to a corporation or enters into some other contract in which he knows that the corporation is acting for some purpose outside of its authorized business. Will mere knowledge of this on A's part preclude him from recovering on the contract when he has performed his side? Where a corporation merely exceeds its powers, the public interest ordinarily is not affected. The contract is not illegal, but unauthorized. A distinction has been suggested between a case of mere knowledge of intended *ultra vires* use of money lent, where the borrower is left free to use it as he pleases, and cases where anything is done by the lender himself in furtherance of such *ultra vires* use, as where it is actually applied by the lender to the purchase of speculative stock on behalf of the borrower.¹⁰⁷ In *Franklin Co. v. Lewiston Institution for Savings*,¹⁰⁸ the F Co. presented for allowance five notes executed by the Savings Bank, amounting to fifty thousand dollars (\$50,000), representing money paid out by the F Co. at the request of the Savings Bank as subscription for capital stock in the Continental Mills, a manufacturing corporation. The F Co. advanced the money to the Mills Co. and took notes of the Savings Bank for the amount, taking a transfer of the stock as security. The original certificate was issued direct to the F Co. and it did not show upon its face that the Savings Bank had any interest in the stock. It was *held* that the plaintiff company could not recover for money paid against the defendant's assignees in insolvency. If the claim had been one for money lent instead of for money paid, the mere knowledge of the plaintiff that it was intended to be used for an *ultra vires* purpose would not preclude recovery; but where the money is paid by the lender in furtherance of the

¹⁰⁷ *Franklin Co. v. Lewiston Institution for Savings*, 68 Me. 43, 28 Am. Rep. 9. By the very terms of the agreement the money was to be applied to an unauthorized purpose.

Jenson v. Toltec Ranch Co., 174 Fed. 86, 92: "It is no defense to a suit to enforce a contract that has been performed by the promisee to repay money loaned to or paid for another and to foreclose a mortgage . . . that the lender or the payor knew that the borrower intended to use or was using the money for an illegal purpose beyond its corporate powers, where the lender or the payor did not com-

bine or conspire with the borrower to induce such a use and did not share in the benefits thereof." *Acc. Grand Valley Water Users' Ass'n v. Zumburn*, 272 Fed. 943.

¹⁰⁸ 68 Me. 43, 28 Am. Rep. 9; *Wright v. Hughes*, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412 (lender may recover unless implicated in borrower's design); *acc. Marion Trust Co. v. Crescent Loan & Investment Co.*, 27 Ind. App. 451, 61 N. E. 688, 87 Am. St. Rep. 257. *Cp. Maryland Trust Co. v. National Mechanic's Bank*, 102 Md. 608, 631, 63 Atl. 70.

ultra vires use, no recovery can be had. It is like a loan of money for the express purpose of enabling the borrower to gamble with it.

It was argued that when a contract has been executed, and the corporation has received a benefit, recovery should be allowed; but it was *held* that since the money was paid directly to the Mills Co. and since title to the stock never for a moment vested in the Savings Bank, the bank was not liable. The court apparently overlooks the point that an equitable title would pass to the bank to the stock which was held as collateral security.

On principle, the claimant's ignorance that the corporation in making the contract had abused its powers would be an essential element in cases where he relies upon an estoppel or a representation by the agents of the corporation that the contract is within the powers of the corporation. But knowledge of the *ultra vires* character should not be a defense in case the corporation is retaining the benefits of the contract,^{108a} or in cases where a tort liability arises in an *ultra vires* transaction. In *Smith v. First Nat. Bank*,¹⁰⁹ the plaintiff knew it was *ultra vires* for the bank to hold or sell a certain note, yet relied upon the representations of the president of the bank that he had it and would sell it. It was held that the plaintiff might sue the bank in deceit.

§ 81. Consent and ratification by stockholders.—An *ultra vires* contract may become binding by the ratification, assent or acquiescence of all the shareholders, according to some courts, but not according to others, unless the public or the creditors are prejudicially affected.

The doctrine is laid down by certain jurisdictions that *ultra vires* acts cannot be ratified so as to validate them even by unanimous assent of all the stockholders.^{109a} This would seem to be erroneous on principle, at least so far as the defense is urged for the benefit

^{108a} *Marin v. Calmenson*, 155 Minn. 282, 197 N. W. 262.

¹⁰⁹ 268 Fed. 780 (action of deceit by one who knew that the corporation was acting *ultra vires* sustained). See note, 21 Columbia Law Rev. 473; 3 Fletcher, Corporations, sec. 1601.

^{109a} *Ashbury Ry. Co. v. Riche*, L. R. 7 H. L. 653. Cp. *Riche v. Ashbury Ry. Co.*, L. R. 9 Exch. 224; *National Trust & Credit Co. v. F. H. Orcutt & Son Co.*, 259 Fed. 830; *Tilden v. Barber*, 268 Fed. 527;

Fletcher, Corporations, secs. 801, 1518.

In *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24, 35 L. Ed. 55, Justice Gray lays it down in this case that the contract of a corporation which is *ultra vires*, that is, outside the objects and purposes of its creation, is wholly void and of no legal effect. It cannot be ratified and no performance on either side can give it any validity, nor be the foundation of any right of action or estoppel.

or protection of the stockholders, which is the principal object rather than the interest of the public or of creditors.

Suppose that the directors who made the *ultra vires* contract held all the corporate stock, and then set up that they had no authority to bind the corporation by the use of the corporate name and seal for that purpose. The contract is made by the only persons interested in the company. Can all the shareholders in the company represent that the company is in this line of business and then put forward the defense that they had misled the person into contracting with the company and so the corporation is not liable? Such a defense is not only without merit, but also dishonest. It would indeed be harsh if a person sold and delivered goods to the president and general manager of a company, who appeared to be acting on the company's behalf, in perfect good faith relying upon what appeared to be the company's promise to pay, and was then told that in law there really was no sale and no promise to pay. This would be all the more unjust if all the directors and stockholders had assented. As the New York court has said:¹¹⁰ "The stockholders are the equitable owners of the corporate property, and if the officers or trustees do an unauthorized act or incur indebtedness which would not create a corporate liability, the stockholders may subsequently ratify the acts and validate the originally unauthorized transaction. . . . And many cases would arise when it would be for the interest of both corporation and stockholders that an unauthorized act of the trustees should be made valid, and when justice and equity would demand that an unauthorized debt should be paid."

Professor Warren states the principle as follows:¹¹¹ "The con-

¹¹⁰ *Martin v. Niagara Falls Mfg. Co.*, 122 N. Y. 165, 172, 25 N. E. 303; *Holmes, Booth & Haydens v. Willard*, 125 N. Y. 75, 25 N. E. 1083, 11 L. R. A. 170 (the directors and stockholders so far acquiesced in the *ultra vires* business that it actually became the business of the corporation); *Holmes v. Crane*, 191 N. Y. App. Div. 820, 182 N. Y. Supp. 270; *Perkins v. Trinity Realty Co.*, 69 N. J. Eq. 723, 61 Atl. 167 (in cases where stockholders have all assented, the doctrine of estoppel is applicable and the plea of *ultra vires* is unavailing); *Lincoln Court Realty Co. v. Kentucky Title Sav. Bank & Trust Co.*, 169 Ky. 840, 185

S. W. 156; *Taylor Feed Pen Co. v. Taylor Nat. Bank* (Tex. Civ. App.), 181 S. W. 534 (assent by stockholders binds corporation).

¹¹¹ See E. H. Warren, *Executory ultra vires transactions*, 24 *Harvard Law Rev.* 534, 536, 537, 543. Unanimous consent of the stockholders to a venture outside the scope of the corporate objects would seem to obviate objection on the score of lack of authority. The United States Supreme Court and the English Courts treat as immaterial the question whether all the shareholders authorized or ratified the *ultra vires* venture.

sent of the shareholders need not be expressed by any formal vote of authorization or ratification. Where the funds of the corporation are openly employed in a venture outside the contemplated scope of corporate action, so that the fact could upon inquiry be ascertained, if the shareholder does not restrain further prosecution of the venture within a reasonable time, it is proper for the law to impose upon him a ratification of such employment. If shareholders are to be protected to the detriment of outsiders against the unauthorized acts of directors and officers, it is not improper to impose a duty upon shareholders to inquire as to the conduct of the directors and officers, and to restrain such conduct, if improper." "Estoppel" to plead *ultra vires* by the retention of benefits of performance may perhaps best be explained as a species of adoption or ratification of an unauthorized contract.

§ 82. Internal irregularities in the exercise of powers.—The doctrine of constructive notice is not applied to cases in which the contract is within the sphere of the general powers or objects of the corporation, but some internal formality, such as a vote of the stockholders, is not complied with.

A corporation acting within the general scope of its powers may be estopped to deny that it has complied with legal formalities which are prerequisite to the authority of its directors, such as a vote or a written request of the stockholders. All who deal with a corporation may be charged with notice of its charter, but votes are matters of "indoor management," and if the directors act within their ostensible authority, the corporation cannot repudiate the act, unless it can show notice.¹¹² In a Supreme Court case¹¹³ a bill in equity was brought by the New Albany Co. to cancel a guar-

In *Fergus Falls Woolen Mills v. Boyum*, 136 Minn. 411, 162 N. W. 516, L. R. A. 1918 A 919, it is held that where a restriction on debts is imposed upon a corporation itself by its charter, the *ultra vires* act of defendant cannot be ratified by the directors, but only by the unanimous action of the stockholders after full knowledge of the facts. See *Olson v. Warroad Mercantile Co.*, 136 Minn. 310, 161 N. W. 713.

¹¹² *Equitable Trust Co. of New York v. Washington-Idaho Water, Light & Power Co.*, 300 Fed. 601, 612, 614; *McKee v. Title Insurance & Trust Co.*, 159 Cal. 206, 221, 113 Pac.

140; *Mahony v. East Hartford Min. Co.*, [1875] L. R. 7 H. L. 869, 893.

¹¹³ *Louisville, N. A. & C. R. Co. v. Louisville Trust Co.*, 174 U. S. 552, 43 L. Ed. 1081, 19 Sup. Ct. 817. See *Gay v. Hudson River Elec. Power Co.*, 190 Fed. 773, 785, holding irregularity in exercise of power by vote of the stockholders to guarantee bonds of another corporation, did not make guaranty *ultra vires* as to purchasers in good faith. 2 *Machen Corps.*, sec. 1475; 3 *Fletcher Corporations*, sec. 1514; *Bell v. Kirkland*, 102 Minn. 213, 113 N. W. 271, 13 L. R. A. (N. S.) 793, 120 Am. St. Rep. 621.

anty endorsed on negotiable bonds of the B. Co., which might get into the hands of *bona fide* purchasers. The plaintiff company had authority by statute to guarantee bonds of railway companies upon the petition of the holders of the majority of the stock of the company. The guaranty was executed by the directors without such authority from the stockholders. It was *held* as to 125 bonds thus guaranteed, which had been sold to the Louisville Trust Co., and as to ten bonds to another purchaser, each of which purchasers took the bonds in good faith and without notice, that the corporation could not set up that the guaranty was made without the required consent of the stockholders. The holders might, however, be enjoined from enforcing the guaranty on the bonds, which were taken with notice of the lack of the petition. The court draws a distinction between the doing of an act beyond the scope of the powers of a corporation, and an irregularity in the exercise of the granted powers.

III. CONVEYANCES AND TRANSFERS TO OR FROM CORPORATIONS; DEVISES AND BEQUESTS.

§ 83. In general.—There is some conflict in the decisions as to the effect of a conveyance or devise or bequest of real or personal property to a corporation in excess of the charter powers or restrictions. The following propositions, however, are established by the weight of authority:

- (1) Unless a corporation is absolutely prohibited and incapacitated to take and hold real or personal property, a conveyance or transfer to it passes the title, and no one but the state can object that the conveyance or transfer was for an unauthorized purpose, or that it was otherwise in excess of the power conferred by its charter.
- (2) An *ultra vires* or prohibited conveyance or transfer of real or personal property by a corporation is not void, but passes the title, and the corporation cannot maintain a suit to set the same aside and recover the property.
- (3) A devise to a corporation is void if not permitted by the statute of wills. Some of the courts hold that a devise to a corporation, although such devises are authorized by the statute of wills, is void if the corporation has no authority under its charter to take and hold the land; but other courts hold the contrary.

Ultra vires or prohibited conveyance of real property to or by corporations.—An *ultra vires* conveyance passes the title, and no one but the state can object that the conveyance was for an unauthorized purpose, or that it was otherwise in excess of the powers conferred upon the corporation by its charter. And it follows that a corporation which has made an *ultra vires* purchase of real estate, and received a conveyance, may not only hold the same, but may also sell it, and convey a good title.¹¹⁴

It has been held, however, in a few cases, that when a corporation is absolutely prohibited by its charter or by statute from taking land, it is wholly incapacitated to do so, and a conveyance to it in violation of the prohibition is void and passes no title; and this rule has been applied when a corporation has exhausted its capacity by having already acquired land to the full limit of its capacity.¹¹⁵

Power of the state to confiscate or escheat land.—Although *dicta* may be found in the text-books, and in many of the cases, to the effect that land acquired by a corporation in excess of its powers, as in the case of land conveyed to an alien not authorized to take and hold land, is subject to escheat or forfeiture by the state, if proper proceedings are instituted to declare a forfeiture, there is no decision in support of any such doctrine. It is no doubt within the power of the legislature to expressly provide for forfeiture to the state of land acquired *ultra vires* by a private corporation, but, in the absence of such a statute, the state cannot confiscate the land of a corporation because it has no power to hold the same. The only remedy of the state is to proceed against the corporation to forfeit its charter, as will be explained in a subsequent chapter.¹¹⁶

¹¹⁴ *McCann v. Children's Home Society of California*, 176 Cal. 359, 168 Pac. 355; *Kerfoot v. Farmers' & Merchants' Bank*, 218 U. S. 281, 54 L. Ed. 1042, 31 Sup. Ct. 14; *Hough v. Cook County Land Co.*, 73 Ill. 23, 24 Am. Rep. 230; *Leazure v. Hillegas*, 7 Serg. & R. (Pa.) 313; *Long v. Georgia Pac. Ry. Co.*, 91 Ala. 519, 8 So. 706, 24 Am. St. Rep. 931; *Fayette Land Co. v. Louisville & N. R. Co.*, 93 Va. 274, 24 S. E. 1016; *Lancaster v. Amsterdam Improvement Co.*, 140 N. Y. 576, 35 N. E. 964, 24 L. R. A. 322. See article, 84 Central Law Journal

174; *State v. American Baptist Home Mission Soc.*, 96 W. Va. 447, 123 S. E. 440, 37 A. L. R. 200.

Courts, however, will not aid a corporation seeking to acquire lands which it has no authority to acquire and hold. *Southern Realty Co. v. Tchula Co-op. Stores*, 114 Miss. 309, 75 So. 121.

¹¹⁵ *St. Peter's Roman Catholic Congregation v. Germain*, 104 Ill. 440; *Cromie's Heirs v. Louisville Orphans' Home Soc.*, 3 Bush. (Ky.) 365. See *Hayden v. Hayden*, 241 Ill. 183, 89 N. E. 347.

¹¹⁶ *Commonwealth v. New York, L. E. & W. R. Co.*, 132 Pa. St. 591,

§ 84. Ultra vires or prohibited transfer of personal property to or by corporations.

The doctrine above stated applies to an *ultra vires* or prohibited transfer of personal property to a corporation. The transfer vests the title in the corporation, and the title cannot be attacked, or an action of replevin, trover, or trespass defeated, on the ground that the purchase of the property was in violation of a prohibition or limitation in its charter or in a general law, or on the ground that it was for a purpose not authorized by its charter.¹¹⁷ This principle applies when a corporation purchases and takes an assignment of a promissory note or other chose in action. It acquires a good title, and its right to maintain an action cannot be questioned on the ground that its taking of the same was for an unauthorized purpose, or was contrary to an express or implied prohibition in its charter.¹¹⁸

§ 85. Devises or bequests to corporations.

There are differences between the effect of a conveyance or transfer of property to a corporation, *inter vivos*, and a devise or bequest. A conveyance or transfer *inter vivos* vests the title in the corporation. A bequest, on the other hand, though authorized by the common law, does not *ipso facto* vest the title in the legatee,

19 Atl. 291, 7 L. R. A. 634. See 8 Harvard Law Rev. 15.

In some states, provision for forfeiture or escheat to the state has been made by statute.

In *State ex rel. Short v. Benevolent Investment & Relief Ass'n*, 107 Okla. 228, 232 Pac. 35, 37 A. L. R. 190 (see note 10 Cornell Law Quart. 501), it is held that conveyance of land to a corporation may vest title in the corporation, although acquiring or holding land is *ultra vires*, and the corporation may convey a good title. In a few states there are charter or statutory limits on the real property a corporation can hold, and also an express statutory or constitutional provision for an escheat or forfeiture in event of breach. Before suit is brought the corporation can convey an indefeasible title.

¹¹⁷ *Ayers v. South Australian Banking Co.*, L. R. 3 P. O. 548; *Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co.*, 53 Hun (N. Y.) 52, 5 N. Y. Supp. 937, aff'd 127 N. Y.

252, 27 N. E. 831, 24 Am. St. Rep. 448; *Parish v. Wheeler*, 22 N. Y. 494.

¹¹⁸ *National Pemberton Bank v. Porter*, 125 Mass. 333, 28 Am. Rep. 235; *Prescott Nat. Bank of Lowell v. Butler*, 157 Mass. 548, 32 N. E. 909; *Baker v. Northwestern Guaranty Loan Co.*, 36 Minn. 185, 30 N. W. 464; *John V. Farwell Co. v. Wolf*, 96 Wis. 10, 70 N. W. 289, 71 N. W. 109, 37 L. R. A. 138, 65 Am. St. Rep. 22. Contra, *Straus v. Eagle Ins. Co. of Cincinnati*, 5 Ohio St. 59.

In *McDonald v. Mulkey*, 32 Wyo. 144, 231 Pac. 662, 667, it is said: "Moreover, in the case at bar, the defendant was not a party to the transaction whereby the bank acquired the notes nor to the transaction, if any, whereby the plaintiff acquired them. Under the issues, as we have seen, it was immaterial to the defendant whether the bank or the plaintiff was the real owner of the notes, so long as the defendant was permitted to make the defense he had pleaded. We have been cited to no authority for permitting a plea

but requires action or consent by the executor, in whom the title vests, and action by the court, if he refuses to consent.¹¹⁹ And a devise of real property, though, like a conveyance, it vests the title directly in the devisee, is valid only when authorized by the statute of wills. For these reasons, among others, the principles which govern *ultra vires* conveyances and transfers to corporations do not necessarily apply to devises and bequests.

It is clear that, if the statute of wills of a state does not allow a devise of land to a corporation, such a devise is necessarily void and of no effect whatever, for it is only by virtue of the statute that land can be devised at all.¹²⁰ This question, however, has nothing to do with the power of the corporation. Suppose, however, that the statute of wills does allow devises to corporations, and a devise is made to a corporation whose charter does not give it the power to take the land. Does the devise, as in the case of a conveyance *inter vivos*, vest the title in the corporation as against every person except the state, or is it void because of the corporation's want of power? To this question the courts have given different answers. Some of the courts have held that the devise in such a case vests the title in the corporation, notwithstanding its want of capacity under its charter, and is valid as against every person but the state.¹²¹ Other courts have held that the principal governing executed conveyances to corporation does not apply, that the devise is void, and that the title to the land vests in the residuary devisees or heirs.¹²²

of *ultra vires* by one who is not a party to, nor injuriously affected by, the unauthorized transaction. See 14a C. J. 335-337; Cook on Corporations (8th Ed.), § 668. It is certainly very doubtful whether the maker of a note can be heard to contend that a transfer thereof has been made by a corporation acting *ultra vires*. Quinn v. First Nat. Bank, 8 Ga. App. 235, 68 S. E. 1010; Winer v. Bank, 89 Ark. 435, 117 S. W. 232, 131 Am. St. Rep. 102, and cases there cited."

¹¹⁹ See Trustees of Davidson College v. Chamber's Ex'rs, 3 Jones Eq. (N. C.) 253. See Warren, Executory *ultra vires* transactions, 24 Harvard Law Rev. 546.

¹²⁰ It is so in New York, for example, where by statute no devise to a corporation is valid unless it is expressly authorized by its charter, or by statute, to take by devise.

McCartee v. Orphan Asylum Soc., 9 Cow. (N. Y.) 437, 18 Am. Dec. 516; Downing v. Marshall, 23 N. Y. 366, 80 Am. Dec. 290; Chamberlain v. Chamberlain, 43 N. Y. 424; White v. Howard, 46 N. Y. 144.

¹²¹ Jones v. Habersham, 107 U. S. 174, 27 L. Ed. 401, 2 Sup. Ct. 336; De Camp v. Dobbins, 29 N. J. Eq. 36; Hanson v. Little Sisters of the Poor of Baltimore, 79 Md. 434, 32 Atl. 1052, 32 L. R. A. 293; In re Stickney's Will, 85 Md. 79, 36 Atl. 654, 35 L. R. A. 693, 60 Am. St. Rep. 308; Farrington v. Putnam, 90 Me. 405, 37 Atl. 652, 38 L. R. A. 339; Hamsher v. Hamsher, 132 Ill. 273, 23 N. E. 1123, 3 L. R. A. 556; Hubbard v. Worcester Art Museum, 194 Mass. 280, 80 N. E. 490, 9 L. R. A. (N. S.) 689, 10 Ann. Cas. 1025.

¹²² In re McGraw's Estate, 111 N. Y. 66, 19 N. E. 233, 2 L. R. A. 387; Heiskell v. Chickasaw Lodge, 87

In re McGraw's Estate,¹²³ it appeared that the charter of Cornell University permitted it to hold property to an amount not exceeding \$3,000,000. The New York statutes gave a corporation the power to hold, purchase and convey real and personal estate not exceeding the amount limited in its charter. It was provided that no devise to a corporation should be valid unless the corporation be expressly authorized by its charter, or by statute to take by devise. Fiske left over one million dollars to Cornell, which had already exceeded its limit. The heirs contested the validity of the bequest to the University as *ultra vires*. It was held in favor of the heirs and next of kin. It was argued that it was for the State alone to attack the title, but the court held that the heirs or next of kin of a testator might raise the question as the devise was void and not merely defeasible by the state. It was also contended that a devise to a corporation vests the title so far as the question of capacity is concerned, whenever a deed of conveyance would pass title. The court, however, held that there was a distinction in the matter of *ultra vires* between an executed sale or conveyance and a devise. A devise is of an executory nature, and the corporation claiming title under the will asks the aid of the law to give the property to it; and in so doing, it must show the authority it has to take. A decision to like effect in a North Carolina case was based upon the ground that a bequest does not vest the title to the property bequeathed directly in the legatee, like a gift or conveyance *inter vivos*, but requires, to give him the title, the consent of the executor, and, if he withholds his consent, action by the court, and that a court will not require the executor to pay or deliver money or property to a corporation in pursuance of a bequest to it, where the corporation has no power under its charter to hold the property.¹²⁴ If a devise or bequest to a corporation is void at the time of the testator's death because the corporation has no power to take the property, the right of the heirs or next of kin or the residuary devisee or legatee thereto becomes vested, and is not

Tenn. 686, 11 S. W. 825, 4 L. R. A. 699; House of Mercy of New York v. Davidson, 90 Tex. 529, 39 S. W. 924. And see Trustees of Davidson College v. Chamber's Ex'rs, 3 Jones, Eq. (N. C.) 253.

¹²³ 111 N. Y. 66, 19 N. E. 233, 2 L. R. A. 387. See Cornell University v. Fiske, 136 U. S. 152, 34 L. Ed. 427, 10 Sup. Ct. 775; House of Mercy of

New York v. Davidson, 90 Tex. 529, 39 S. W. 924; Farrington v. Putnam, 90 Me. 405, 37 Atl. 652, 38 L. R. A. 339; Congregational Church Bldg. Soc. v. Everett, 85 Md. 79, 36 Atl. 654, 35 L. R. A. 693, 60 Am. St. Rep. 308.

¹²⁴ Trustees of Davidson College v. Chamber's Ex'rs, 3 Jones Eq. (N. C.) 253 (Nash, C. J., dissenting).

affected by subsequent legislation conferring additional power upon the corporation.¹²⁵

In *Hubbard v. Worcester Art Museum*,¹²⁶ it was held that a gift made by will to a charitable corporation, in excess of the amount limited or permitted by statute, was good against everyone but the State. If, after the will is proved, a special statute is passed, authorizing the corporation to hold real and personal property to an amount exceeding that received, this operates as a waiver of the right of the state to terminate the holding. The Massachusetts court denies that there is any distinction between titles taken under wills and those taken by grant. When a will is proved, it takes effect immediately to pass all property affected by it. The act of a testator in executing the will is confirmed and given effect as a complete and executed disposition of the property by the allowance of the will.

IV. REMEDIES.

§ 86. Who may question validity of *ultra vires* acts.—An excess of corporate power can be questioned only by a person whose interests are in some way affected. The doctrine of *ultra vires* can be invoked only at the instance of the state, the corporation, its stockholders or creditors whose rights are infringed, or the other party to a contract who is affected by the lack of corporate authority. Not every *ultra vires* act is ground for forfeiture in *quo warranto*, unless the public interest is threatened.

The restrictions imposed under the doctrine of *ultra vires* are supposedly not purely arbitrary, but are calculated to protect the interests of various sets of parties who may be concerned. *First*, and foremost the interest of the stockholders is to be regarded, that the capital shall not be subjected to the risk of enterprises not contemplated by the articles of incorporation, and therefore not authorized by the stockholders or their predecessors in subscribing for stock.¹²⁷ *Second*, there is a possible interest in the creditors of the corporation to confine its activities to their proper scope, especially

¹²⁵ Trustees of Davidson College v. Chamber's Ex'rs, 3 Jones Eq. (N. C.) 253; In re McGraw's Estate, 111 N. Y. 66, 19 N. E. 233, 2 L. R. A. 387.

¹²⁶ 194 Mass. 280, 80 N. E. 490, 9 L. R. A. (N. S.) 689, 10 Ann. Cas. 1025; Farrington v. Putnam, 90 Me. 405, 37 Atl. 652, 38 L. R. A. 339;

Hubbard v. Worcester Art Museum, 179 Fed. 406; see note 20 Harvard Law Rev. 561.

¹²⁷ Pittsburgh, C. & St. L. R. Co. v. Keokuk & H. Bridge Co., 131 U. S. 371, 384, 9 Sup. Ct. 770, 33 L. Ed. 157; Olsen v. Warroad Mercantile Co., 136 Minn. 310, 161 N. W. 713.

in the case of bondholders. *Third*, there is the supposed interest of the public, often theoretical and shadowy, that the corporation shall not transcend its publicly avowed purposes and objects, or the restrictions imposed upon it by its charter or by the general law. The interest of the public is to be protected and conserved by the state, and not by the individual stockholder or person dealing with the corporation. The right of the stockholder to object for the protection of his own interest may be lost by his own consent or acquiescence. The corporation itself is allowed to set up the objection of *ultra vires* for the benefit of the various classes of persons whose interests are involved. The person dealing with the corporation may also, in case of executory contracts, take advantage of the corporate lack of authority, possibly on grounds of lack of mutuality of obligation.

It has been contended by learned writers seeking to clarify and rationalize the confused law of *ultra vires*, that if it is to the interest of the public that corporations shall not transcend their powers, let the public officers proceed by direct attack, rather than that persons contracting with corporations be kept in doubt and uncertainty. Persons dealing with corporations ought not to be required at their peril to examine and construe its charter provisions. No contract made in good faith ought to be held void merely because a stockholder might object.¹²⁸ Mr. W. B. Hale has suggested the following statute:¹²⁹ "No such corporation or any person or corporation dealing therewith shall be excused from the full performance of any contract made between such parties on the ground that said contract was not within the charter powers of such corporation, or was in abuse of its charter powers; and all relief based upon the *ultra vires* character of corporate contracts shall be restricted to suits in *quo warranto*, and stockholders' proceedings in equity." The purpose of such a provision would be to eliminate all questions of *ultra vires* as a basis of collateral attack as in the case of chartered corporations at common law.

§ 86a. *Quo warranto* by the state.—An *ultra vires* act by a corporation may furnish a ground of forfeiture for which the

¹²⁸ W. B. Hale, 11 Illinois Law Rev. 8, 10.

¹²⁹ 11 Illinois Law Rev. 8, 10. See also, Proc. Canadian Bar Ass'n 1922, p. 382; Gurd, 2 Canadian Bar Rev. 485, 488; Stevens, A proposal as to the codification and restatement of

the *ultra vires* doctrine, 36 Yale Law Journal 297, 321.

See Treatment of the doctrine of *ultra vires* in the new Ohio Corporation Law, 27 Columbia Law Rev. 594; Ballantine, 12 Cornell Law Quart 453, (June, 1927),

state may proceed against it by *quo warranto* to forfeit its charter, or the state may maintain *quo warranto* to oust it from the exercise of the unauthorized power.

When the state creates a corporation, the grant of the charter is said to be on the implied condition that the corporation shall act within the powers conferred upon it. *Ultra vires* acts, whether otherwise wrong or not, are a breach of this condition. Such an act does not of itself put an end to the existence of the corporation, but it is, subject to qualifications which will hereafter be explained, ground for a direct proceeding by the state to obtain a judgment of forfeiture.¹³⁰ But it is not for the commission of every *ultra vires* act that a charter will be declared forfeited. The courts are clothed with discretion as to whether the interests of the public demand such a judgment. The transgression must be wilful, continued, and such as to menace the public welfare.¹³¹ When a corporation is guilty of exercising powers not authorized by its charter, the state, instead of proceeding against it to obtain a judgment forfeiting its charter, may proceed, by *quo warranto*, to obtain a judgment merely ousting it from the further exercise of the unauthorized powers.¹³²

§ 86b. Remedy in equity by injunction.—A minority of the stockholders of a corporation, or a single stockholder, may maintain a suit to restrain a corporation or its officers from diverting its funds to unauthorized purposes, or from carrying out an *ultra vires* contract. And a suit in equity may be maintained by other persons to enjoin an *ultra vires* act if it constitutes a violation of their private rights, and there is no adequate remedy at law. But a suit in equity does not lie on behalf of the state to enjoin *ultra vires* acts.

¹³⁰ *People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843; *State v. Oberlin Building & Loan Ass'n*, 35 Ohio St. 258. See post, § 261.

Forfeiture of charter only remedy where no other penalty prescribed. *State v. W. L. Harris Realty Co.*, 148 Minn. 20, 180 N. W. 776. See *People ex rel. Los Angeles Bar Ass'n v. California Protective Corp.*, — Cal. App. —, 244 Pac. 1089 (*quo warranto* held proper remedy where corporation wilfully usurps privilege of

practicing law); *Fletcher, Corporations*, sec. 1524.

¹³¹ *State ex rel. Johnson v. Southern B. & L. Ass'n*, 132 Ala. 50, 31 So. 375; *People v. North River Sugar Ref. Co.*, 121 N. Y. 582, 24 N. E. 834; *State v. Minnesota Thresher Mfg. Co.*, 40 Minn. 213, 41 N. W. 1020, 3 L. R. A. 510.

¹³² *People v. Utica Ins. Co.*, 15 Johns. (N. Y.) 358, 8 Am. Dec. 243; *Attorney General v. City of Salem*, 103 Mass. 138; *People v. River Raisin & L. E. R. Co.*, 12 Mich. 389, 86 Am. Dec. 64.

Suit by the attorney-general.—A court of equity, in the absence of a statute, has no jurisdiction of a bill or information by the attorney or solicitor general in the name or on behalf of the state to restrain a corporation from engaging in transactions which are prohibited or not authorized by its charter, if this is the only ground for relief.¹³³ In such a case the remedy of the state is at law by an information in the nature of *quo warranto*, either to forfeit the charter of the corporation, or to oust it from the exercise of the unauthorized or prohibited powers, as is elsewhere shown.

Suit by stockholders.—The stockholders of a corporation, however, have a right to expect and to insist that its funds shall not be diverted either by giving them away or by employing them in an *ultra vires* business or transaction, and any stockholder, therefore, has such an interest that he may apply to a court of equity for an injunction to prevent such a diversion, even though all the other stockholders may consent. Thus, it was held in a leading English case that a shareholder in a railroad company could maintain a bill in equity to enjoin the company from taking proceedings to form a steam-packet company to run a line of packets beyond the terminus of its road, and guarantying a certain dividend on the stock of the packet company.¹³⁴ The stockholder has his remedy when the threatened commission or continued performance of acts on behalf of a corporation is outside the scope of the corporation's authorized business. Each stockholder is entitled to say to the others or to the corporation: "I became a member in a concern formed for a definite purpose, and upon terms which were agreed upon by all of us, and you have no right, without my consent, to engage me in any other concern, or to hold me to any other terms." ¹³⁵

¹³³ Attorney General v. Tudor Ice Co., 104 Mass. 239, 6 Am. Rep. 227; Attorney General v. Utica Ins. Co., 2 Johns. Ch. (N. Y.) 371; Independent Order of Foresters v. United Order, 94 Wis. 234, 68 N. W. 1011. See 7 R. C. L. 612; 36 Yale Law Journal 307.

¹³⁴ Colman v. Eastern Counties Ry. Co., 10 Beav. 1. See also, Tomkinson v. Southeastern Ry. Co., 35 Ch. Div. 675. But see Wormser v. Metropolitan St. R. Co., 184 N. Y. 83, 76 N. E. 1036, 112 Am. St. Rep. 596, 6 Ann. Cas. 123 (stockholder

cannot complain of alleged *ultra vires* acts after he has taken benefits thereunder).

¹³⁵ The charter constitutes a contract between the corporation and its stockholders. This means that the corporate body is under an obligation to each of the shareholders to conduct the corporate business according to the charter or constitution of the company and for the purposes specified. Any stockholder may object to an *ultra vires* act and compel the corporation to refrain

Creditors.—It is sometimes suggested that creditors of a corporation have some status or interest to restrain the unauthorized acts of the corporation, on the theory that credit was given with knowledge of the purposes of the corporation. The creditor assumes the risk of failure along this line, but should not be subjected to the risks of speculations in other lines. The idea might almost be stretched to an implied agreement that a corporation will confine the use of its capital to the authorized corporate business. The *intra vires* creditors might thus be given precedence over *ultra vires* creditors.¹³⁶ The bondholder is not merely a lender, but to a certain extent an investor in a business financed through bonds. He should have rights similar to those of the stockholder to prevent his investment from being altered without his consent.¹³⁷ However, "it is probably the law that a creditor cannot restrain a corporation from embarking its funds upon a venture outside the contemplated scope of corporate action, unless his security is endangered."¹³⁸ The prejudice to the creditor is ordinarily merely conjectural. Bondholders may if they desire exact a covenant from the borrower as to the business to be conducted.

from breach of the charter contract. *Natusch v. Irving* (1824) Gow, Partnership, App. VI, p. 398.

¹³⁶ *State v. Bank of Hemingford*, 58 Neb. 818, 80 N. W. 50. A bank engaged in a systematic course of unauthorized dealing in merchandise. Creditors who furnished it articles in and about such business may collect the price and the bank cannot set up that it had no power to make the contracts out of which the debts arose. But depositors who dealt with the bank as a bank, and not as a storekeeper are entitled to be preferred over creditors whose accounts originated in the unauthorized business, until funds taken from the bank for the store business are fully repaid.

American Exp. Co. v. Citizens' State Bank, 181 Wis. 172, 194 N. W. 427, 433. Insolvent bank may set up *ultra vires* against guaranty for protection of depositors. See *J. L. Parks*, Mo. Law Bulletin, series 25, p. 9.

¹³⁷ See *Isaacs*, 37 Harvard Law Rev. 210; *Marin v. Calmenson*, 158 Minn. 282, 197 N. W. 262. Cf. *Stevens*, 36 Yale Law Journal 315.

¹³⁸ *Mills v. Northern Ry.*, 5 Ch. App. 621; *Brent v. Simpson*, 238 Fed. 285, 291; *Lincoln Court Realty Co. v. Kentucky Title Sav. Bank & Trust Co.*, 169 Ky. 840, 185 S. W. 156. Cf. *Washington Mill Co. v. Sprague Lumber Co.*, 19 Wash. 165, 174, 52 Pac. 1067, mortgage void as to creditors, though assented to by all stockholders.

CHAPTER VIII.

TORTS, CRIMES, AND CONTEMPT OF COURT.

§ 87. Liability of corporations for torts—In general.

- (1) As a general rule, a corporation is responsible for torts of its officers or agents or servants within the scope of their employment the same as an individual principal or employer.
- (2) It is liable for a tort so committed, although it involves a specific intent or malice, as fraud or malicious prosecution.
- (3) It is liable for exemplary damages, in a proper case, for the torts of its managing officers, or for torts of subordinate agents authorized or ratified by them, although there is some conflict as to when exemplary damages are proper.
- (4) It is liable, according to the weight of authority, although the tort may have been committed in the course of an ultra vires business or transaction, if such business or transaction was authorized by its stockholders or managing officers.
- (5) It is not liable for torts of an agent not within the scope of his employment, unless it has ratified the same.
- (6) According to the weight of authority, a corporation organized exclusively for the purpose of a public charity is not liable to a patient or other person receiving the benefit of the charity for the torts of its employees, unless it has been negligent in selecting or retaining them.

Formerly there was some notion that a corporation could not do acts not authorized by its charter, and it was thought, therefore, that, in the nature of things, a corporation could not commit a tort, the wrongful acts of its officers and agents being regarded as their own torts individually, and not as the torts of the corpora-

tion.¹ In an early Pennsylvania case² a Turnpike Co. was sued in trespass on the case for wrongfully erecting piers on each side of a rivulet and overflowing plaintiff's tanyard. It was argued by counsel on behalf of the defendant that a corporation from its nature is incapable of committing a tort. Corporations are creatures of the law. A corporation never was and never can be authorized to commit a tort; it is outside the corporate powers to appoint an agent for that purpose. A body corporate can only act in strict pursuance of the objects of its incorporation. It was argued on the other hand for the plaintiff that the master is responsible for the wrongs of the servant, not because he has given him authority to do an illegal act, but from the relation existing between them. The argument of defendant would lead to absolute immunity of corporations for every species of wrong.

The court decided for the plaintiff and held that the defendant's argument was fallacious in its principles and mischievous in its consequences. A corporation may do great damage through its laborers who have no property to answer for it. There is no ground for distinction between corporation employers and individual employers. The doctrine of *respondeat superior* applies to both. It was declared by the court that from the earliest time to the present, corporations have been held liable for torts.³ It is no defense in tort that the corporation was not authorized by its charter to do wrong. As the California court has said:⁴ "It may seem severe to impose upon innocent stockholders damages for the tortious acts of the directors of the corporation when it must be conceded that such acts are in excess of their authority.

¹ *Orr v. Bank of United States*, 1 Ohio St. 36, 13 Am. Dec. 588 (corporation not liable for assault and battery).

² *Chestnut Hill & Spring House Turnpike Co. v. Rutter*, 4 Serg. & R. (Pa.) 6, 8 Am. Dec. 675.

³ "It would thus seem that so far as criminal or civil liability is concerned the courts have always been prepared to hold that a corporation is as capable of being held liable as a natural person." Holdsworth, 31 Yale Law Journal 382, 388; 3 History of English Law (3rd Ed.), p. 488. See Warren, 23 Harvard Law Rev. 498; 21 Columbia Law Rev. 475; 2 Machen, Corporations, sec. 1072.

⁴ *Maynard v. Fireman's Fund Ins.*

Co., 34 Cal. 48, 91 Am. Dec. 672; s. c. on rehearing, 47 Cal. 207. See *Standard Oil Co. v. Anderson*, 212 U. S. 215, 220, 53 L. Ed. 480, 29 Sup. Ct. 252. In *Higgins v. Water-vliet Turnpike Co.*, 46 N. Y. 23, it is said: "The principal is bound by a contract made in his name by an agent, only when the agent has an actual or apparent authority to make it; but the liability of a master for the tort of his servant does not depend primarily upon the possession of authority (actual or apparent) to commit it. . . . It is sufficient to make the master responsible *civilliter*, if the wrongful act of the servant was committed in the business of the master. . . . This rule is founded upon public policy."

. . . It should be remembered that the stockholders select from their number the directors, and intrust to their management the business of the corporation, and consequently assume the risk of loss from their misconduct." If they do an injury to another the corporation is in law answerable for it, and also for the wrongs of other agents and employees acting in the scope of their employment, whether they are high or low in authority.

In accordance with this doctrine, it has repeatedly been held that a corporation is liable for a trespass committed by its employee in the course of his employment, whether it be trespass upon land,⁵ or upon goods,⁶ or against the person, as an assault and battery.⁷ A corporation is also liable in trover for the conversion of property by its officers or agents in the course of their employment.⁸ And it is liable in an action on the case or other appropriate action for a nuisance erected, created, or maintained by its officers or agents in the course of their employment;⁹ or for their negligence.¹⁰

§ 88. Torts involving wrongful intent or malice.

It has been contended that, in the nature of things, a corporation cannot be guilty of or liable for tort involving intention or malice, like deceit, of which an intent to defraud is an essential element, and malicious prosecution, etc., in which the element of malice enters. It was argued that such malicious intent cannot belong to the body of the stockholders, who themselves are not really implicated in the acts of their officers and agents, nor to the fictitious, ideal entity.¹¹ But these theoretical difficulties of "imputing" malice to a corporation have been brushed aside in modern law.

⁵ *Maund v. Monmouthshire Canal Co.*, 4 Man. & G. 452; *Chestnut Hill & Spring House Turnpike Co. v. Rutter*, 4 Serg. & R. (Pa.) 6, 8 Am. Dec. 675.

⁶ *Yarborough v. Bank of England*, 16 East 6; *Maund v. Monmouthshire Canal Co.*, 4 Man. & G. 452.

⁷ *Eastern Counties Ry. Co. v. Broom*, 6 Exch. 314; *Brokaw v. New Jersey R. & Transp. Co.*, 32 N. J. Law 328, 90 Am. Dec. 659; *New York, L. E. & W. R. Co. v. Haring*, 47 N. J. Law 137, 54 Am. Rep. 123; *Maisenbacker v. Society Concordia*, 71 Conn. 369, 42 Atl. 67, 71 Am. St. Rep. 213.

⁸ *Yarborough v. Bank of England*,

16 East 6; *Fishkill Sav. Institution v. National Bank of Fishkill*, 80 N. Y. 162, 36 Am. Rep. 595.

⁹ *Chestnut Hill & Spring House Turnpike Co. v. Rutter*, 4 Serg. & R. (Pa.) 6, 8 Am. Dec. 675; *Burbank v. Bethel Steam Mill Co.*, 75 Me. 373, 46 Am. Rep. 400; *Columbus & Hocking Coal & Iron Co. v. Tucker*, 48 Ohio St. 41, 26 N. E. 630, 12 L. R. A. 577, 29 Am. St. Rep. 528.

¹⁰ *Central Railroad & Banking Co. v. Smith*, 76 Ala. 572, 52 Am. Rep. 353; *Nims v. Mt. Hermon Boys' School*, 160 Mass. 177, 35 N. E. 776, 22 L. R. A. 364, 39 Am. St. Rep. 467.

¹¹ See *Abrath v. Northeastern Ry. Co.*, 11 A. C. 247, per Bramwell, "a

Corporations are to be regarded as principals or employers acting by agents and servants, and responsible for their torts like ordinary individuals. A libel published by a servant or agent falls within the rule, if uttered in the course of his employment, while engaged in furthering the business of his principal or master.¹² Some courts make a distinction between libel and slander, and hold that a corporation is not responsible for slanderous words spoken by its officer or agent, unless the speaking of them was expressly authorized, directed or ratified.¹³ But there seems no reason why a corporation should not be responsible for a slander uttered by an agent to the same extent as for a libel published by an agent, or for any tort committed by him in the scope of his employment.¹⁴

While it is true that a corporation itself cannot entertain any intent or malice, there is no reason why a specific intent or malice entertained by an officer or agent of a corporation, in doing an act for the corporation in the course of his employment, should not be imputed to the corporation, just as the act of the officer or agent is imputed to it. The true basis of liability is not that the act of the servant is in contemplation of law the act of the corporation; but that the corporation or employer is responsible for injury to third parties inflicted in carrying on the business.¹⁵

corporation is incapable of malice or of motive"; *Baty, Vicarious Liability*, p. 68.

¹² *Citizens Life Assur. Co. v. Brown*, L. R. [1904] App. Cas. 423; *Philadelphia, W. & B. R. Co. v. Quigley*, 21 How. (U. S.) 202, 16 L. Ed. 73; *Maynard v. Fireman's Fund Ins. Co.*, 34 Cal. 48, 47 Cal. 207, 91 Am. Dec. 672; *Fogg v. Boston & L. R. Corp.*, 148 Mass. 513, 20 N. E. 109, 12 Am. St. Rep. 583; *Behre v. National Cash Register Co.*, 100 Ga. 213, 27 S. E. 986, 62 Am. St. Rep. 320; *Vowels v. Yakish*, 191 Iowa 368, 179 N. W. 117, 13 A. L. R. 1132, 1142 note on Liability of insurance company for libel or slander by its agents or employees. "In many cases the practical question is whether the agent or employee was acting within the scope of his employment." See note in 6 Iowa Law Bul. 123.

¹³ See *McIntyre v. Cudahy Packing Co.*, 179 Ala. 404, 60 So. 848; *Southern Ry. Co. v. Chambers*, 126 Ga. 404, 55 S. E. 37, 7 L. R. A. (N. S.) 926; *Southern Ice Co. v. Black*,

136 Tenn. 391, 189 S. W. 861, Ann. Cas. 1917E 695. Compare, contra, *Buckeye Cotton Oil Co. v. Sloan*, 250 Fed. 712, 719; *Mills v. W. T. Grant Co.*, 233 Mass. 140, 123 N. E. 618.

¹⁴ *Roemer v. Jacob Schmidt Brewing Co.*, 132 Minn. 399, 157 N. W. 640, L. R. A. 1916E 771; *Hypes v. Southern R. Co.*, 82 S. C. 315, 64 S. E. 395, 21 L. R. A. (N. S.) 873, 21 Ann. Cas. 620.

¹⁵ "It is sometimes said that the act of an agent is, in law, the act of his principal; but it is well to bear in mind that this is a mere fiction. . . . Sometimes the principal is chargeable by reason of his previous consent, sometimes by reason of his subsequent adoption of the act of the agent, and sometimes by reason of a rule of positive law established upon grounds of public policy. It is for the latter reason that a principal may often be held civilly responsible for the torts of his agents, though in no manner at fault himself." 2 *Morawetz Corporations* (2nd Ed.), § 732.

It is now well settled, therefore, both in England and this country, that fraud or deceit on the part of an officer or agent of a corporation, in transactions which are within the scope of his authority, is imputable to the corporation, not only for the purpose of avoiding contracts and other transactions as against the corporation,¹⁶ but also for the purpose of an action of deceit against the corporation.¹⁷ It is also well settled that a corporation may, to the same extent as a natural principal, be liable for the wilful and malicious wrongs of its officers or agents, if committed in the course of a transaction which is within the scope of their employment,¹⁸ for malicious criminal prosecution or malicious false arrest or imprisonment,¹⁹ for malicious prosecution of a civil action, attachment, or other proceeding,²⁰ for malicious interference with the business of another,²¹ and for conspiracy.²²

Peterson v. Western U. Tel. Co., 75 Minn. 368, 373, 77 N. W. 985. One who employs another to carry on business or do work for his benefit, and who controls the employee, ought to take the risk of injury to third parties by the manner in which his business is carried on. Servants may be irresponsible, and the risk of wrongdoing should be imposed on the employer who creates the dangers and gets the benefits of the business.

"The fact that the business in which the accident occurs is carried on for the employer and that he is probably able to indemnify himself out of the proceeds makes it not unjust that he should bear at least a considerable part of the risk of causing injuries to persons in carrying on the business; and the fact that as a class employees have been lacking in financial ability makes it socially expedient that the employer be required to pay. . . . The fact that he is held as an insurer only against this limited class of risks should not obscure the true basis of his liability." *A. A. Ballantine, Compensation Plan For Railway Accident Claims*, 29 *Harvard Law Rev.* 705, 712, 714.

¹⁶ *Western Bank of Scotland v. Addie*, L. R. 1 H. L. Sc. 157; *Cragie v. Hadley*, 99 N. Y. 131, 1 N. E. 537, 52 Am. Rep. 9; *Carr v. National Bank & Loan Co.*, 167 N. Y. 375, 60 N. E. 649, 82 Am. St. Rep. 725.

¹⁷ *Ranger v. Great Western Ry.*

Co., 5 H. L. Cas. 72; *Peebles v. Patapsco Guano Co.*, 77 N. C. 233, 24 Am. Rep. 447; *Erie City Iron Works v. Barber*, 106 Pa. St. 125, 51 Am. Rep. 508; *Johnston Fife Hat Co. v. National Bank of Guthrie*, 4 Okla. 17, 44 Pac. 192; *McCord v. Western U. Tel. Co.*, 39 Minn. 181, 39 N. W. 315, 1 L. R. A. 143, 12 Am. St. Rep. 636 (*maxim respondeat superior* applies to corporations, though act of servant is wilful, malicious or fraudulent).

¹⁸ *Green v. London General Omnibus Co.*, 7 C. B. (N. S.) 290; *Philadelphia, W. & B. R. Co. v. Quigley*, 21 How. (U. S.) 202, 16 L. Ed. 73; *Goodspeed v. East Haddam Bank*, 22 Conn. 530, 58 Am. Dec. 439; *Lake Shore & M. S. Ry. Co. v. Prentice*, 147 U. S. 101, 37 L. Ed. 97, 13 Sup. Ct. 261.

¹⁹ *Eastern Counties Ry. Co. v. Broom*, 6 Exch. 314; *Lake Shore & M. S. Ry. Co. v. Prentice*, 147 U. S. 101, 37 L. Ed. 97, 13 Sup. Ct. 261; *Jordan v. Alabama Great Southern R. Co.*, 74 Ala. 85, 49 Am. Rep. 800; *Boogher v. Life Ass'n of America*, 75 Mo. 319, 42 Am. Rep. 413.

²⁰ *Goodspeed v. East Haddam Bank*, 22 Conn. 530, 58 Am. Dec. 439. And see *Wheeler & Wilson Mfg. Co. v. Boyce*, 36 Kan. 350, 13 Pac. 609, 59 Am. Rep. 571.

²¹ *Green v. London General Omnibus Co.*, 7 C. B. (N. S.) 290; *Pratt v. British Medical Ass'n*, [1919] 1 K. B. 244, 279.

²² *Zinc Carbonate Co. v. First Nat.*

§ 89. Liability for exemplary damages.

In the case of actual fraud, and in the case of torts committed with actual malice or wantonly and oppressively, and in cases of gross negligence, a jury is allowed to give the person injured exemplary or punitive damages, as well as such damages as will compensate him for the actual injury. Exemplary damages are not necessarily to be regarded as a pure gift to the injured person. For many wrongs the law cannot give adequate compensation in money. The ordinary measure of damages does not cover the entire loss. Exemplary damages may often be regarded as merely a more liberal measure of compensation allowed in view of the aggravated nature of the wrong and the culpability of the defendant. The courts, however, do not agree as to the circumstances under which it is proper to give such damages against a corporation. Exemplary or punitive damages are awarded, according to the usually accepted theory, not by way of compensation to the sufferer, but by way of punishment of the wrongdoer, and as an example or warning to others, and they can only be awarded against one who has participated in the offense. By the weight of authority, therefore, a principal, although he is liable to make *compensation* for injuries done or inflicted by his agent within the scope of his employment, cannot be held liable for exemplary or punitive damages *merely* by reason of wanton, oppressive, or malicious intent upon the part of the agent. In order that the principal may be liable, there must have been some participation on his part.²³ There is no good reason in law why a master should be punished like a criminal for acts which he did not do and could not prevent, although some courts refuse to distinguish between the guilt of the servant and the guilt of the employer.

Applying this doctrine to corporations, it has been held that where the managing officers or officer of a corporation, as the

Bank of Shellsburg, 103 Wis. 125, 79 N. W. 229, 74 Am. St. Rep. 845; Dorsey Machine Co. v. McCaffrey, 139 Ind. 545, 38 N. E. 208, 47 Am. St. Rep. 290; Johnston Fife Hat Co. v. National Bank of Guthrie, 4 Okla. 17, 44 Pac. 192.

²³ Lake Shore & M. S. Ry. Co. v. Prentice, 147 U. S. 101, 37 L. Ed. 97, 102, 13 Sup. Ct. 261, 263. Railroad not liable in exemplary damages for unauthorized violence by conductor. See note 7 Harvard Law Rev. 45; Aetna Life Ins. Co. v. Brewer, 12 Fed. (2d) 818, 821.

But in many cases a corporate principal or master has been held subject to exemplary damages for the wilful, wanton or malicious acts of the servant or agent, although the master was personally without blame. There seems however, no basis for adding punishment to compensation unless the master has been guilty in some way. 2 Mechem, Agency (2nd Ed.) §§ 2014, 2016. See exemplary damages for tort, 33 Harvard Law Rev. 111; 14 Mich. Law Rev. 506.

directors, the president, or managing officer, commit a tort themselves, while acting for the corporation and within the scope of their authority, with wantonness, oppressiveness, or malice, or if they authorize or ratify such a tort by a subordinate agent, or if they employ or retain a subordinate agent or servant, knowing that he is incompetent or unfit, and he commits such a tort because of his incompetency or unfitness, in either case the malice, wantonness, or oppression is imputable to the corporation, and exemplary damages may be given against it.²⁴

It is argued that if a corporation is guilty of no fault or neglect in selecting its agents and employees it should not be compelled to pay a penalty for a malicious act committed without its consent or knowledge. It may be just to compel the stockholders who have the chance of profit to bear the burdens of the business, such as the losses due to the improper conduct of the business, but it is an entirely different matter to punish the innocent stockholders for a wrong committed by another person.²⁵

Some courts, however, go to the extreme of permitting the award of exemplary damages against a corporation whenever any servant may be so punished for wrongs done in the course of his employment. Other courts hold that the corporation is not so liable for wrongs done by inferior agents or servants unless the managing officers of the company have authorized the wrong or ratified it. Even in this class of cases the shareholders who are made to bear the punishment are not shown to have been blameworthy in any

²⁴ Corporation is liable for punitive damages if the malicious purpose is that of the governing officers. *Bishop v. Readsboro Chair Mfg. Co.*, 85 Vt. 141, 81 Atl. 454, 36 L. R. A. (N. S.) 1171, Ann. Cas. 1914B 1163; *Sparrow v. Vermont Sav. Bank*, 95 Vt. 29, 112 Atl. 205; *Lake Shore & M. S. Ry. Co. v. Prentice*, 147 U. S. 101, 37 L. Ed. 97, 13 Sup. Ct. 261; *Merrills v. Tariff Mfg. Co.*, 10 Conn. 384, 27 Am. Dec. 682; *Singer Mfg. Co. v. Holdfodt*, 86 Ill. 455, 29 Am. Rep. 43; *Wheeler & Wilson Mfg. Co. v. Boyce*, 36 Kan. 350, 13 Pac. 609, 59 Am. Rep. 571; *Cleghorn v. New York Cent. & H. River R. Co.*, 56 N. Y. 44, 15 Am. St. Rep. 375. See *Forrester v. Southern Pac. Co.*, 36 Nev. 247, 134 Pac. 753, 136 Pac. 705, 48 L. R. A. (N. S.) 1, 38 note; 12 Mich. Law Rev. 237; *White v. International Textbook Co.*, 173 Iowa 192, 155 N. W. 298. But see *Emmke*

v. De Silva, 293 Fed. 17, 22. Hotel company is not liable in punitive damages for act of president, active in management of the hotel, though he owned a large part of the stock of the company, if it did not authorize or ratify his conduct.

Liability to respond in punitive damages is ordinarily limited to the wrongdoer. *Peterson v. Middlesex & S. Traction Co.*, 71 N. J. Law 296, 59 Atl. 456.

²⁵ *Morawetz, Corporations* (2nd Ed.), sec. 728. See *Lake Shore & M. S. Ry. Co. v. Prentice*, 147 U. S. 101, 37 L. Ed. 97, 13 Sup. Ct. 261 (explaining and distinguishing *Denver & R. G. Ry. Co. v. Harris*, 122 U. S. 597, 30 L. Ed. 1146, 7 Sup. Ct. 1286); *Wardrobe v. California Stage Co.*, 7 Cal. 118, 68 Am. Dec. 231; *Cleghorn v. New York Cent. & H. R. R. Co.*, 56 N. Y. 44, 15 Am. Rep. 375.

way. Since a corporation can only act by agents, it is difficult to explain why it should be punishable even for the wilful wrongs of its superior officials, unless this be deemed a necessary means of regulating the conduct of the business.²⁶

§ 90. Torts in *ultra vires* business or transaction.

In a few cases it has been held that if the officers of a corporation engage in an *ultra vires* business or transaction, and a tort is committed in the course of such business or transaction, either by the managing officers, or by a subordinate agent under authority from them, the corporation is not liable. Thus, in a Maryland case, where a national bank had engaged in the business of selling the bonds of a railroad company on commission, and the teller of the bank made false and fraudulent representations to induce a person to purchase bonds, it was held that an action for the deceit would not lie against the bank. The decision was based by the court, not on the ground that the teller was not authorized by the managing officers of the bank to make the sale, but on the ground that the business was *ultra vires*, and on this ground only.²⁷

²⁶ See *Goddard v. Grand Trunk Ry. of Canada*, 57 Me. 202, 2 Am. St. Rep. 39; *Clark v. Bland*, 181 N. C. 110, 106 S. E. 491; 21 Columbia Law Rev. 824; *Sparrow v. Vermont Sav. Bank*, 95 Vt. 29, 112 Atl. 205. Compare *Helppie v. Northwestern Drainage Co.*, 127 Minn. 360, 149 N. W. 461 (treble damages under statute for wilful trespass by servant in scope of his employment, though without the defendant's knowledge); *Jones v. Shannon*, 55 Mont. 225, 175 Pac. 882.

²⁷ *Weekler v. First Nat. Bank of Hagerstown*, 42 Md. 581, 20 Am. St. Rep. 95. See also, *Gunn v. Central R. R. Co.*, 74 Ga. 509; *Bathe v. Decatur Co. Agricultural Soc.*, 73 Iowa 11, 34 N. W. 484, 5 Am. St. Rep. 651; *Brokaw v. New Jersey R. & Transp. Co.*, 32 N. J. Law 328: "The directors are only agents themselves, and their powers are necessarily limited within the scope of the purposes for which the corporation was created, beyond which they are not authorized to bind the corporation. To fix the liability of a corporation for the tortious act of one of its employees, done in obedience to the commands

of its officers, the act must be connected with the transaction of the business for which the company was incorporated."

A corporation is liable for its servant's torts done within the course of his employment, not because the corporation has capacity to commit a tort, but because the corporation is bound by the ordinary law of master and servant to liability for its servants. But even if directors expressly authorize an *ultra vires* act and employ servants in work which is *ultra vires*, are not the directors acting outside the scope of their agency so that they do not create the relation of master and servant with the corporation so as to make it liable? 2 Cambridge Law Journal 350, *Corporate Liability in Tort*.

In *Valentine v. Road Directors of Alleghany Co.*, 146 Ind. 199, 126 Atl. 147, it is held that a municipal corporation is not liable for negligent construction of a bridge outside its jurisdiction. See 38 Harvard Law Rev. 401, 527; *Ducey v. Inhabitants of Webster*, 237 Mass. 497, 130 N. E. 53.

This view, however, cannot be sustained, and the great weight of authority is against it. If a subordinate agent or servant of a corporation engages in an *ultra vires* transaction without any authority from the managing officers, and commits a tort in the course of such transaction, the corporation is not liable. But this is because his act is not within the scope of his employment, and not merely because it beyond the powers of the corporation. A very different case is presented when the stockholders of a corporation at a corporate meeting, or the directors or managing officers, authorize or engage in an *ultra vires* business or transaction. In such a case the business is that of the corporation, though unauthorized by its charter, and for torts committed in the course of such business it is liable. A corporation, though it has no authority to engage in an *ultra vires* business, has responsibility for doing so. The doctrine that it is liable in such a case is well supported by authority.²⁸

All wrongs done by servants of a corporation are in a sense *ultra vires*, and it is no defense that the business in which the servant was employed was foreign to the objects or purposes of the corporation if it was being carried on for the benefit of the corporation.²⁹ In accordance with this doctrine, it has been held that a railroad company, if it engages in the *ultra vires* business of running a steamboat, horse-car, or stage line in connection with its road, is liable for injuries caused by the negligence or other torts of its agents or servants in the conduct of such business;³⁰ and that railroad companies which enter into an *ultra vires* con-

²⁸ Nims v. Mt. Hermon Boys' School, 160 Mass. 177, 35 N. E. 776, 22 L. R. A. 364; 39 Am. St. Rep. 467; Central Railroad & Banking Co. v. Smith, 76 Ala. 572, 52 Am. Rep. 353; Salt Lake City v. Hollister, 118 U. S. 256, 30 L. Ed. 176, 6 Sup. Ct. 1055; New York, L. E. & W. R. Co. v. Haring, 47 N. J. Law, 137, 54 Am. Rep. 123; Hutchinson v. Western & A. R. Co., 6 Heisk. (Tenn.) 634; Bissell v. Michigan Southern & N. I. R. R. Co., 22 N. Y. 258; Hannon v. Siegel-Cooper Co., 167 N. Y. 244, 60 N. E. 597, 52 L. R. A. 429; Chamberlain v. Southern California Edison Co., 167 Cal. 500, 140 Pac. 25; Smith v. First Nat. Bank of Casselton, N. D., 268 Fed. 780; Staake v. Routledge, 111 Tex. 489, 241 S. W. 994. See 21 Col. Law Rev. 475; Warren, Torts in *ultra*

vires undertakings, 2 Cambridge Law Journal 180.

²⁹ Hannon v. Siegel-Cooper Co., 167 N. Y. 244, 60 N. E. 597, 52 L. R. A. 429. The defendant, a corporation conducting a department store, represented to plaintiff that it was conducting a dentist's business in its store. Although it was beyond the corporate powers of the defendant to engage in this business, yet this did not relieve it from liability for the torts of its servants, such as malpractice or negligence.

³⁰ Central Railroad & Banking Co. v. Smith, 76 Ala. 572, 52 Am. St. Rep. 353; Hutchinson v. Western & Atlantic R. Co., 6 Heisk. (Tenn.) 634; New York, L. E. & W. R. Co. v. Haring, 47 N. J. Law 137, 54 Am. Rep. 123.

solidation agreement are liable for injury to a passenger and his baggage from negligence in the joint operation of their roads.³¹ It is no defense to an action against an educational corporation for personal injuries to a passenger, upon a boat used at a public ferry operated by the corporation, through the negligence of the ferry man in managing the boat, that the maintenance of the ferry was *ultra vires*. Although the contract to carry the plaintiff was *ultra vires*, and therefore invalid, the defendant owes a duty growing out of the relation to carry safely.³² It is a sufficient evidence of authority or ratification if the stockholders or members know that the business had been done by those who assumed to act as its agents in doing it, and that the income of the business had been received, and the expenses of it paid by its treasurer. It has also been held that, when a corporation becomes a bailee of property, it cannot escape liability in tort for conversion of the property, or for loss or injury due to its negligence, on the ground that the contract of bailment was not authorized by its charter.³³

§ 91. Unauthorized torts.

An individual employer is not responsible for the wrongful acts of his servant unless the act is expressly authorized, or is within the scope of the employment, or unless it is ratified. And the same is true with respect to the liability of a corporation for the wrongful acts of its agents and employees.³⁴ The corporation is not liable for the torts of persons employed in an *ultra vires* transaction, unless the business was previously authorized or subsequently ratified. In an Alabama case it is held that the authority must result from corporate action, as distinguished from the individual action of the stockholders or officers.^{34a}

³¹ Bissell v. Michigan Southern & N. I. R. Co., 22 N. Y. 258.

³² Nims v. Mt. Hermon Boys' School, 160 Mass. 177, 35 N. E. 776, 39 Am. St. Rep. 467.

³³ First Nat. Bank of Monmouth v. Strang, 138 Ill. 347, 27 N. E. 903; First Nat. Bank of Carlisle v. Graham, 100 U. S. 699, 25 L. Ed. 750. Bank receiving bonds for safekeeping, although not authorized to do so, cannot set up *ultra vires* to escape from liability for loss due to negligence.

³⁴ See Vowles v. Yakish, 191 Iowa 368, 179 N. W. 117, 13 A. L. R. 1132, 1142n, and see comment on this case in 6 Iowa Law Bul. 123; Case v. Steel Coal Co., 162 Ky. 68, 171 S. W.

993, L. R. A. 1915D 867. If a servant steps aside from his employment and acts on his own account, as where he includes a libelous and loathsome joke in a statement of account, the act is not considered to be done in the scope of his employment as the corporation's bookkeeper. See note 24 Am. Law Rep. 133 (libel or slander of another employee as within scope of employee's authority); 13 Am. Law Rep. 1142 note.

^{34a} Central R. & Banking Co. v. Smith, 76 Ala. 572, 52 Am. Rep. 353. See corporate liability in tort and the doctrine of *ultra vires*, Goodhart, 2 Cambridge Law Journal 350. Can an *ultra vires* undertaking be held

§ 92. Liability by reason of ratification.

Although a tort may have been committed by an officer or agent of a corporation without either actual or apparent authority, the corporation may become liable therefor by reason of a ratification or adoption of the act, provided the act was done for its benefit. In this respect corporations are subject to the same rule as applies to natural persons.⁸⁵ For example, if a corporation expressly adopts or ratifies a contract made by an officer or agent without authority, or if it impliedly ratifies the same by accepting the benefits, or by failure to repudiate the same, it also becomes liable for false and fraudulent representations made by the officer or agent to induce the other party to enter into the contract.⁸⁶

§ 93. Liability of charitable corporations—For tort.

Although there is authority to the contrary, the weight of authority is to the effect that a corporation created for the purpose of maintaining a public charity, the funds of which are derived from public and private donations for such purpose, and are held by it exclusively for such purpose, is not liable to a beneficiary or patient for the negligence or wrongful acts of its agents or servants, unless it has failed to use due care in employing or re-

to be the business of the corporation! Directors are agents of the company and can only bind the corporation by contracts made within the scope of that agency. It would take the unanimous approval of all the shareholders before their authority under the charter could be extended. But see *Campbell v. Paddington Corporation*, [1911] 1 K. B. 869.

⁸⁵ *Choctaw Coal & Mining Co. v. Lillich*, 204 Ala. 533, 86 So. 383, 11 A. L. R. 1014; *Morehouse v. Northrop*, 33 Conn. 380, 89 Am. Dec. 211; *Garrison v. Technic Electrical Works*, 55 N. J. Eq. 708, 37 Atl. 741; *Carr v. National Bank & Loan Co. v. Wattertown*, 167 N. Y. 375, 60 N. E. 649, 82 Am. St. Rep. 725; *Owens v. Boyd Land Co.*, 95 Va. 560, 28 S. E. 950; *Nims v. Mount Hermon Boys' School*, 160 Mass. 177, 35 N. E. 776, 22 L. R. A. 364, 39 Am. St. Rep. 467; *Dempsey v. Chambers*, 154 Mass. 330, 28 N. E. 279, 13 L. R. A. 219, 26 Am. St. Rep. 249.

It would seem that ratification need not be by formal vote. It is sufficient that the corporation, act-

ing through its managing officers, with knowledge that the business had been done on its behalf, received the income and paid the expenses. Ratification results from the reception and retention of the fruits and benefits, when the stockholders might elect to repudiate and disavow the acts of those who have assumed authority. *Nims v. Mt. Hermon Boys' School*, 160 Mass. 177, 35 N. E. 776, 22 L. R. A. 364, 39 Am. St. Rep. 467.

⁸⁶ *Morehouse v. Northrop*, 33 Conn. 380, 89 Am. Dec. 211; *Adams v. Irving Nat. Bank of New York*, 116 N. Y. 606, 23 N. E. 7, 6 L. R. A. 491, 15 Am. St. Rep. 447; *Garrison v. Technic Electrical Works*, 55 N. J. Eq. 708, 37 Atl. 741; *Owens v. Boyd Land Co.*, 95 Va. 560; *Second Nat. Bank of St. Paul v. Howe*, 40 Minn. 390, 12 Am. St. Rep. 744. But a corporation was held not liable in deceit for the fraud of a promoter, even though the corporation adopted the contract in connection with which the fraud was committed. *Langley v. Mohr*, 146 Minn. 394, 178 N. W. 943.

taining them. This doctrine has been applied to corporations for the purpose of maintaining hospitals and similar institutions, in actions against them by patients or other persons receiving treatment or care, for injuries resulting from the negligence or wrongful act of a physician, nurse or other attendant.³⁷ But it is not limited to such corporations. It has been applied to other charitable corporations, as a corporation for the purpose of maintaining a house of refuge³⁸ or industrial school.³⁹

To come within this doctrine, a corporation must be a purely charitable corporation.⁴⁰ Thus, it has been held that the rule does not apply to a cemetery corporation,⁴¹ or to a Young Men's Christian Association.⁴² According to some of the cases, a corporation for the purpose of maintaining a hospital or other public charity is none the less exempt from liability under this doctrine because of the fact that it receives pay from patients who are able to pay.⁴³

Some courts deny that exemption from liability is in accordance with a wise public policy. In a Minnesota case it is declared unjust that the widow and children of the deceased, rather than the corporation, should suffer the loss caused by the fault of the corporation's employees, or in other words be compelled to contribute the amount of their loss to the purposes of even the most worthy corporation.⁴⁴

³⁷ McDonald v. Massachusetts General Hospital, 120 Mass. 432, 21 Am. St. Rep. 529; Roosen v. Peter Bent Brigham Hospital, 235 Mass. 66, 126 N. E. 392, 14 A. L. R. 563, 572 note (hospital not liable through negligence of medical attendants, although not selected with due care, overruling dictum in McDonald case). See note 20 Columbia Law Rev. 708; Perry v. House of Refuge, 63 Md. 20, 52 Am. Rep. 495; Downes v. Harper Hospital, 101 Mich. 555, 60 N. W. 42, 45 Am. St. Rep. 427. Compare, however, Glavin v. Rhode Island Hospital, 12 R. I. 411, 34 Am. Rep. 675.

³⁸ Perry v. House of Refuge, 63 Md. 20, 52 Am. Rep. 495.

³⁹ Williamson v. Louisville Industrial School of Reform, 95 Ky. 251, 24 S. W. 1065, 23 L. R. A. 200, 44 Am. St. Rep. 243; Corbett v. St. Vincent's Industrial School, 177 N. Y. 16, 68 N. E. 997.

⁴⁰ Newcomb v. Boston Protective

Dept., 151 Mass. 215, 24 N. E. 39, 6 L. R. A. 778.

⁴¹ Donnelly v. Boston Catholic Cemetery Ass'n, 146 Mass. 163, 15 N. E. 505. See Canton Cemetery Ass'n v. Slayman, 99 Ohio St. 28, 121 N. E. 819; note 17 Michigan Law Rev. 601.

⁴² Chapin v. Holyoke Y. M. C. A., 165 Mass. 280, 42 N. E. 1130. See Hordern v. Salvation Army, 199 N. Y. 233, 92 N. E. 626, 32 L. R. A. (N. S.) 62, 139 Am. St. Rep. 889.

⁴³ McDonald v. Massachusetts General Hospital, 120 Mass. 432, 21 Am. Rep. 529; Downes v. Harper Hospital, 101 Mich. 555, 60 N. W. 42, 25 L. R. A. 602, 45 Am. St. Rep. 427. Contra, Glavin v. Rhode Island Hospital, 12 R. I. 411, 34 Am. Rep. 675.

⁴⁴ Mulliner v. Evangelischer Diakonies-Senverein, 144 Minn. 392, 175 N. W. 699. See Tucker v. Mobile Infirmary Ass'n, 191 Ala. 572, 68 So. 4, L. R. A. 1915D 1167.

The attempt to find a public policy extending immunity to a charitable corporation for torts of its agents and servants has been justified on several theories. One is that the rule of *respondet superior* is itself based on public policy and this is an exception to foster public charity and preserve its benefits for the public.⁴⁵ Another theory of exemption is sometimes called the "trust fund theory," that trust funds should not be diverted from the charitable purposes designated by the donor.⁴⁶ Still another theory is that of "implied assent" or assumption of risk. By this theory the beneficiary of a charity is held to assume the risk of injury by the negligence of servants of the corporation by accepting the benefits of the charity.⁴⁷ But the weight of authority appears to be that a charity will be liable to strangers for injuries negligently done them by its servants, as for the negligence of an ambulance driver in running down a traveler on the highway. There is said to be a tendency in the later cases to hold the charity liable except where liability may be held to have been waived by contract.⁴⁸

§ 94. Criminal liability of corporations.—Since a corporation can only act by agents or servants a corporation can properly be held criminally responsible only for public nuisances or for the violation of police regulations where a master is made absolutely liable for the acts of his servants, or where statutes impose crimi-

⁴⁵ *Vermillion v. Woman's College of Due West*, 104 S. C. 197, 88 S. E. 649. *Contra*, *Basabo v. Salvation Army*, 35 R. I. 22, 85 Atl. 120, 42 L. R. A. (N. S.) 1144. See note, Liability of charitable corporations for tort, 31 *Harvard Law Rev.* 479; 14 A. L. R. 572; 23 A. L. R. 923.

⁴⁶ *Abston v. Waldon Academy*, 118 Tenn. 24, 102 S. W. 351, 11 L. R. A. (N. S.) 1179. Compare *Love v. Nashville Agri. & Normal Institute*, 146 Tenn. 550, 243 S. W. 304, 23 A. L. R. 887; *Tucker v. Mobile Infirmary*, 191 Ala. 572, 68 So. 4, L. R. A. 1915D 1167; notes in 7 *Minnesota Law Rev.* 57; 17 *Michigan Law Rev.* 601; 34 *Yale Law Journal* 316; 20 *Illinois Law Rev.* 373.

⁴⁷ *Powers v. Massachusetts Homoeopathic Hospital*, 109 Fed. 294, 300, 65 L. R. A. 372; *Hordern v. Salvation Army*, 199 N. Y. 233, 92 N. E. 626, 32 L. R. A. (N. S.) 62, 139 *Am. St. Rep.* 889; *Phillips v. Buffalo*

General Hospital, 239 N. Y. 188, 146 N. E. 194; *Schloendorff v. Society of New York Hospital*, 211 N. Y. 125, 105 N. E. 92, 52 L. R. A. (N. S.) 505, *Ann. Cas.* 1915C 581. See notes 14 A. L. R. 572; 23 A. L. R. 923.

See article by McCaskill, *respondet superior* as applied to quasi-public and eleemosynary corporations, 5 *Cornell Law Quart.* 409; 6 *Cornell Law Quart.* 56; 9 *Cornell Law Quart.* 269; 22 *Michigan Law Rev.* 259; 28 *Harvard Law Rev.* 725.

⁴⁸ See notes on liability of privately conducted charity for personal injuries, in 14 A. L. R. 52; 23 A. L. R. 923; *Taylor v. Flower Deaconess Home & Hospital*, 104 Ohio St. 61, 135 N. E. 28, 23 A. L. R. 900 (negligence in selection of physicians, nurses or attendants). *Charitable corporation, Liability for torts of its servants*, 2 *Wisconsin Law Rev.* 246.

nal liability on corporations for the acts of their employees and agents. Such are statutes against rebating and discrimination in railroad rates.

It was formerly doubted whether a corporation could be prosecuted for any crime. Lord Holt is reported as having said that "a corporation is not indictable, but the particular members of it are."⁴⁹ This doctrine, however, if it has ever obtained, is not now recognized in any jurisdiction. On the contrary, it is well settled that a corporation may to some extent be punishable for the criminal acts or omissions of its officers or agents, just as it may be civilly liable in damages for their torts. In the nature of things, a corporation cannot be imprisoned, but it may be fined, and the fine may be enforced against its property, or its charter may be forfeited because of its misuser or abuse.⁵⁰

Public nuisance consisting of malfeasance or misfeasance.—In several of the earlier cases a distinction was made, with respect to the criminal responsibility of corporations, between nonfeasance, and malfeasance or misfeasance, and, while it was conceded that an indictment would lie against a corporation for nonfeasance (as for nonrepair of a road) it was held that it would not lie for malfeasance or misfeasance, as for a nuisance created by erecting a dam across a navigable river,⁵¹ or by digging up a highway and placing stones and dirt therein.⁵² These cases, however, have not been followed. On the contrary, it is now settled, both in England

⁴⁹ Anonymous case, [1696] 12 Mod. 559. See Blackstone Commentaries, chap. 18: "A corporation cannot commit treason or felony or other crime in its corporate capacity, though its members may in their individual capacities." *Orr v. Bank of United States* (1822) 1 Ohio 36, 13 Am. Dec. 588 (semble). See *Baty, Vicarious Liability*, p. 67; *Francis, Criminal Responsibility of the Corporation*, 18 Illinois Law Rev. 305.

⁵⁰ *Reg. v. Birmingham & Gloucester Ry. Co.*, 3 Q. B. 223, 9 Carr. & P. 469; *Reg. v. Great North of England Ry. Co.*, 9 Q. B. 315 (nuisance); *State v. Passaic County Agr. Soc.*, 54 N. J. Law 260, 23 Atl. 680; *Commonwealth v. Pulaski County Agricultural & Mechanical Ass'n*, 92 Ky. 197, 201, 17 S. W. 442; *State v. Southern R. Co.*, 145 N. C. 495, 59 S.

E. 570, 13 L. R. A. (N. S.) 966; *Union Colliery Co. v. The Queen*, 31 Can. S. C. 81, 2 B. R. C. 222, 231 note.

Liability of corporation for crime, see 30 Yale Law Journal 415; 5 Minnesota Law Rev. 74; *Canfield, Corporate responsibility for crime*, 14 Columbia Law Rev. 469; *Francis, Criminal responsibility of the corporation*, 18 Illinois Law Rev. 305; *Collier*, 71 Central Law Journal 421; *Edgerton*, 36 Yale Law Journ. 827.

⁵¹ *State v. Great Works Milling & Mfg. Co.*, 20 Me. 41, 37 Am. Dec. 38 (affirmative criminal acts on the part of its agents considered as entirely outside the corporate powers), overruled by *State v. Portland*, 74 Me. 268, 43 Am. Rep. 586.

⁵² *Commonwealth v. Swift Run Gap Turnpike Co.*, 2 Va. Cas. 362.

and in this country, that a corporation may be indicted for creating a public nuisance by malfeasance or misfeasance,—as for nuisance in obstructing a public highway by cutting through the same, stopping cars thereon, building stations or other structures thereon, or other positive acts;⁵³ for nuisance in obstructing a navigable river by building a bridge or dam across the same;⁵⁴ for polluting a watercourse by casting offensive matter therein;⁵⁵ for permitting gaming on its premises;⁵⁶ for keeping a disorderly house,⁵⁷ and for cutting down timber and thereby obstructing a river, in violation of a statute.⁵⁸

Corporations are also punishable for various misdemeanors consisting in the violation by their agents or servants of police regulations as to the conduct of business, as for violation of a statute punishing usury;⁵⁹ for violation of a statute punishing contractors for exacting from laborers more than eight hours' labor per day on public work;⁶⁰ for peddling by an agent without a license;⁶¹ or violation of the weights and measures law by giving short weight on a sale of ice.⁶² These are offenses for which the law imposes a penalty on the employer irrespective of his culpability, and even though the employee had been given instructions to comply with the laws.

Offenses involving malice or evil intent.—It has been said that a corporation cannot be guilty of an offense which involves the element of malice or evil intent,^{62a} but the extent to which this is

⁵³ Reg. v. Great North of England Ry. Co., 9 Q. B. 315; State v. Morris & E. R. Co., 23 N. J. Law 360.

⁵⁴ Commonwealth v. Proprietors of New Bedford Bridge, 2 Gray (Mass.) 339.

⁵⁵ Rex v. Medley, 6 Car. & P. 292; State v. City of Portland, 74 Me. 268, 43 Am. Rep. 586.

⁵⁶ Commonwealth v. Pulaski County Agricultural & Mechanical Ass'n, 92 Ky. 197, 17 S. W. 442.

⁵⁷ State v. Passaic County Agr. Soc., 54 N. J. Law 260, 23 Atl. 680.

⁵⁸ State v. White Oak River Corp., 111 N. C. 661, 16 S. E. 331.

⁵⁹ State v. Security Bank of Clark, 2 S. D. 538, 51 N. W. 337.

⁶⁰ United States v. John Kelso Co., 86 Fed. 304.

⁶¹ Standard Oil Co. v. Commonwealth, 107 Ky. 606, 55 S. W. 8.

⁶² State v. People's Ice Co., 124

Minn. 307, 144 N. W. 962. See 43 L. R. A. (N. S.) 36, 42n.

^{62a} Reg. v. Great North of England Ry. Co., 9 Q. B. 315; Reg. v. Birmingham & Gloucester Ry. Co., 3 Q. B. 223; Commonwealth v. Proprietors of New Bedford Bridge, 2 Gray (Mass.) 339.

A, B and C are partners in the real estate business. A, while purporting to act for the firm, but without authority, obtains money by false pretenses from D. A, B and C are each indicted for the crime. Can B and C be punished for the act of A? Suppose A, B and C were incorporated as the A, B, C Co., Ltd., and A was the president when he committed the fraud in the business of the corporation, should the corporation be held criminally liable? Assume that the proceeds of the crime went into the corporate treasury.

true is by no means clear. It is held, as we have seen, that a corporation may be held liable in a civil action for wrongs of its officers and agents involving the element of malice, and that it may be subjected to exemplary or punitive damages under some circumstances, as where superior officers are implicated.

It has been argued that the liability of the corporation for punitive damages for the torts of its principal executive officers might well be extended to make it criminally liable for offenses committed by them in its behalf.⁶³ This is reasoning from a very unreliable premise. It is very questionable whether there is any just basis for allowing exemplary damages against an employer or corporation except in so far as they give a more liberal measure of compensation for an aggravated injury. If a corporation can be held liable in damages for the torts of its agents and servants involving malice does it follow that it can be held liable to punishment for their crimes? Not at all. As was argued by counsel in a Rhode Island case: "In civil cases a party has been injured and is seeking compensation. Balancing the equities of the plaintiff and the stockholders of the defendant corporation, it has seemed more just that the person injured should be reimbursed. . . . But in criminal cases . . . to punish an innocent stockholder for an offense really committed by an officer of the corporation can have no basis in justice."⁶⁴

The formula that the act of an agent is the act of the principal is a mere fiction. The principal may often be held responsible for the tort of his servant, though in no manner at fault himself by reason of a positive rule of social insurance adopted on grounds of public policy. It is very exceptional when public policy demands that a person or corporation should be punished on account of a wrong committed by a servant or even by a superior officer. In ordinary cases a master is not liable criminally for an

⁶³ 30 Yale Law Journal 415, note.

"The very basis of the action for libel or for malicious prosecution is the evil intent, the malice, of the party defendant. It is difficult, therefore, to see how a corporation may be amenable to civil suit for libel and malicious prosecution and private nuisance, and mulcted in exemplary damages, and at the same time not be indictable for like offenses, where the injury falls upon the public." *State v. Passaic County Agr. Soc.*, 54 N. J. Law 260, 23 Atl. 680. See, also, *Commonwealth*

v. Pulaski County Agricultural & Mechanical Ass'n, 92 Ky. 197, 17 S. W. 442; *State v. Baltimore & O. R. Co.*, 15 W. Va. 362, 36 Am. St. Rep. 803; *Memphis Telephone Co. v. Cumberland Telephone & Telegraph Co.*, 231 Fed. 835.

⁶⁴ *State v. Eastern Coal Co.*, 29 R. I. 254, 70 Atl. 1, 132 Am. St. Rep. 817, 17 Ann. Cas. 96 (corporation may be prosecuted for criminal conspiracy since it may be held in tort for conspiracy of its servants or agents). See *United States v. MacAndrews & Forbes Co.*, 149 Fed. 823.

offense committed by his servant, and a corporation cannot be punished for a criminal offense except in those cases where vicarious liability is imposed on the master. This is sometimes done, where the penalty is imposed as a method of enforcement whether the employer has any culpability or not. But masters are not punished for crimes of their servants where the personal intent or malice is an essential ingredient in the offense. "The element of conscious wrongdoing, the guilty mind accompanying the guilty act, is associated with the concept of crimes which are punished as infamous." But there are many minor offenses arising from the violation of so called police regulations, in which the penalty is imposed as a method of enforcement and in which the law does not inquire into the culpability of the offender.^{64a}

The idea that a corporation cannot be charged criminally with a crime involving malice, corrupt intent or moral guilt has been denied by some eminent judges in recent cases. Thus Hough, J., declared, "I think this is but the remnant of a theory, always fanciful, in process of abandonment."⁶⁵ Learned Hand, J., has asserted that, "There is no distinction in essence between civil and criminal liability of corporations based on the element of intent or wrongful purpose. . . . Each is merely the imputation to the corporation of the mental condition of its agents."⁶⁶ It has even been held that a corporation may be convicted and punished for the act of its servants in obtaining property by false pretenses.^{66a} And in a Massachusetts case it was held that a corporation is indictable for a criminal contempt of court (publishing an article in a newspaper concerning a pending trial, which is calculated to prejudice the jury and prevent a fair trial), although a criminal contempt involves a specific intent as a necessary element.⁶⁷

^{64a} Tenement House Dept. of City of New York v. McDevitt, 215 N. Y. 160, 168, 169, 109 N. E. 88, Ann. Cas. 1917A 455; People ex rel. Price v. Sheffield Farms-Slawson-Decker Co., 225 N. Y. 25, 121 N. E. 474.

⁶⁵ United States v. McAndrews & Forbes Co., 149 Fed. 823, 837. See Edgerton, Corporate criminal responsibility, 36 Yale Law Journal 827.

⁶⁶ United States v. Nearing, 252 Fed. 223, 231; United States v. American Socialist Soc., 260 Fed. 885. It is said by the Rhode Island court: "If corporations have the capacity to engage in actionable conspiracy

they have the power to criminally conspire." State v. Eastern Coal Co., 29 R. I. 254, 268, 70 Atl. 1, 132 Am. St. Rep. 817, 17 Ann. Cas. 96.

^{66a} State v. Salisbury Ice & Fuel Co., 166 N. C. 366, 81 S. E. 737, 52 L. R. A. (N. S.) 216, Ann. Cas. 1916C 456. See People v. Hudson Valley Const. Co., 217 N. Y. 172, 111 N. E. 472; 27 Harvard Law Rev. 589. Compare Androscooggin Water Power Co. v. Bethel Steam Mill Co., 64 Me. 441.

⁶⁷ Telegram Newspaper Co. v. Commonwealth, 172 Mass. 294, 52 N. E. 445, 44 L. R. A. 159, 70 Am. St.

These cases illustrate an ill-advised attempt to ingraft upon the criminal law a theory of liability that may have some rational basis in the case of torts caused by a servant, but none in criminal responsibility where there must be participation by the defendant or a statute showing that the legislature intended to impose criminal liability upon employers without fault. The learned judges fail to discriminate between the different grounds of liability in tort and crime. In ordinary cases a master cannot be held criminally for the offenses committed by the servant which he has not authorized, nor can the corporation be held guilty. But in the case of police regulations where certain acts are forbidden under penalty of a fine, the master may be made liable whether he had any *mens rea* or not and this liability may extend to the corporate master or employer.⁶⁸ It may be considered that there can be no effectual means for deterring corporate agents from the violation of certain public regulations in the course of their business except the threat of prosecution of the corporate employer. The basis of the punishment is the prevention of the offense and the enforcement of the law, apart from any question of actual culpability. Statutes imposing absolute liability in this way are constitutional, if a reasonable means of controlling the business activities of corporations.⁶⁹

Offenses involving personal violence.—It has commonly been said that a corporation cannot be guilty of felony or of an offense involving the element of personal violence, as assault and battery, riots, etc.;⁷⁰ punishment for such offenses usually involves personal culpability. A, a conductor employed by a street railway company criminally assaults B, a passenger, in a dispute

Rep. 280. See *Lineker v. Dillon*, 275 Fed. 460. See also, *State v. Atchison*, 3 Lea (Tenn.) 729, 31 Am. Rep. 663; *People v. Star Co.*, 135 App. Div. 517, 120 N. Y. Supp. 498 (publishing a libel); 20 Harvard Law Rev. 153.

⁶⁸ *Griffiths v. Studebakers, Ltd.*, L. R. [1924] 1 K. B. 102; *Mousell Bros. v. London & N. W. Ry. Co. L. R.* [1917] 2 K. B. 845.

⁶⁹ "While *prima facie* a principal is not to be made criminally responsible for the acts of his servants, yet the legislature may prohibit an act or enforce a duty in such words as to make the prohibition or the duty

absolute; in which case the principal is liable if the act is in fact done by his servants." See 28 Yale Law Journal 700.

⁶⁹ *New York Cent. & H. R. R. Co. v. United States*, 212 U. S. 481, 53 L. Ed. 613, 29 Sup. Ct. 304.

Corporate responsibility for crime, G. F. Canfield, 14 Columbia Law Rev. 469; 28 Yale Law Journal 700; 2 Mechem, Agency, secs. 2007, 2008.

⁷⁰ *Reg. v. Birmingham & Gloucester Ry. Co.*, 3 Q. B. 223; *Reg. v. Great North of England Ry. Co.*, 9 Commonwealth v. Proprietors of New Bedford Bridge, 2 Gray (Mass.) 339.

over a transfer. The corporation is prosecuted for a criminal assault. It defends on the ground that an employer is not criminally responsible for offenses committed by its employees in the course of their employment in the absence of statute imposing a penalty for failure to prevent such acts, irrespective of fault or intent. Can a conviction of the corporation be sustained for such an offense? As we have seen, a corporation may be held liable in a civil action for an assault and battery committed by its officers or agents, and subjected to exemplary damages, and there is at least one decision that it may be indicted and fined for such an offense committed by its servants.⁷¹

Negligent manslaughter.—Liability to punishment for culpable negligence must grow out of the personal responsibility of the defendant for doing or not doing the acts complained of. While in tort actions one may be held to answer in damages for the negligence of his servants, in crime guilt is personal, and no principle or *respondeat superior* governs criminal responsibility. The New York court has held that under the statutory definition of homicide as "the killing of one human being by the act, procurement or omission of another," a corporation could not be prosecuted for manslaughter because of the negligence of its servants in installing apparatus in a residence in such a manner that gas escaped and caused the death of an inmate. But the court indicated that a definition of manslaughter might be formulated that would be applicable to a corporation.⁷²

In a recent New Jersey case,⁷³ however, a railway corporation through the gross negligence of its servants in loading its cars

⁷¹ *State v. Rowland Lumber Co.*, 153 N. C. 610, 69 S. E. 58.

⁷² *People v. Rochester Railway & Light Co.*, 195 N. Y. 102, 88 N. E. 22, 21 L. R. A. (N. S.) 998, 133 Am. St. Rep. 770, 16 Ann. Cas. 837.

⁷³ *State v. Lehigh Valley R. Co.*, 94 N. J. Law 171, 175, 111 Atl. 257, 10 A. L. R. 997, aff'g 90 N. J. Law 372, 103 Atl. 685. See notes 5 Minn. Law Rev. 74, 19 Michigan Law Rev. 205; acc. *United States v. Van Schaick*, 134 Fed. 592. Contra, *Commonwealth v. Illinois Cent. R. Co.*, 152 Ky. 320, 153 S. W. 459, 45 L. R. A. (N. S.) 344, Ann. Cas. 1915B 617 (corporation not liable for involuntary manslaughter by gross and wilful negligence of its servants in ab-

sence of statute). *Reg. v. Great Western Laundry Co.*, [1900] 3 Manitoba Law Rep. 66. See also, *Commonwealth v. New Bedford Bridge*, 2 Gray (Mass.) 339; *State v. Morris & E. R. Co.*, 23 N. J. Law 360; *Union Colliery Co. v. The Queen*, 31 Can. S. C. 81, 2 B. R. C. 222, 231n (a corporation may be indicted for criminal negligence in omitting without excuse to avoid danger to human life from anything in its charge or under its control, viz., rotten timbers in railroad bridge. Offense resulted in death, but was not dealt with as manslaughter, but as criminal negligence).

with excessive quantities of highly explosive ammunition caused the death of a brakeman. It was indicted for manslaughter, convicted and fined. The conviction was upheld by the highest court. Four judges dissented on the ground that a corporation cannot be held criminally responsible for an offense which was felony at common law or involved *malus animus* (wicked or evil mind) without express legislative enactment. Manslaughter was punishable by a fine or by imprisonment or by both.

Without special statutory enactment, a corporation cannot properly be held criminally liable for serious crimes (such as felonies) of which personal wickedness or wilful wrongdoing is an essential element at common law. But a positive duty or obligation may be imposed upon vessel owners, corporate or individual, to provide life preservers or life boats, under penalty of liability for manslaughter in case the life of any person is destroyed.⁷⁴ No doubt railroad corporations may by statute be made indictable and subject to fine for causing the death of a person by culpable negligence of their servants, particularly in such matters as providing proper safeguards and facilities.

In determining the extent of punishment of a corporation, the law must consider upon whom the punishment will really fall. Suppose that all the members of a corporation should authorize a crime to be committed in the name of the corporation by a servant in connection with the corporate business. Could the members be punished both in their corporate capacity and also as individuals? Would this not be double jeopardy? Even if a large majority of the stockholders authorize murder or false pretenses there is still some difficulty about punishing the innocent dissenting minority.⁷⁵ The Standard Oil Company of Indiana, in a case that attracted wide attention, was fined over 29 million dollars for accepting rebates or concessions from a railroad company under which oil was transported at less than the published rates. The fine was the maximum penalty provided for as many offenses as there were carloads. The judgment was reversed partly on the ground that the penalty was excessive and an abuse of discretion. Such a penalty might fall not only on the stockholders, but on the creditors by wiping out the assets to which its creditors might look.⁷⁶

⁷⁴ United States v. Van Schaick, 134 Fed. 592.

⁷⁵ See article, Impolicy of Making Corporations Indictable, Collier, 71

Central Law Journal 421. Compare Edgerton, 36 Yale Law Journal 827.

⁷⁶ Standard Oil Co. of Indiana v. United States, 164 Fed. 376, 387.

Inapplicability of penalty.—Even if it be conceded that a corporation has the capacity to commit a particular crime, it cannot be indicted therefor if the punishment prescribed for the crime cannot be imposed upon a corporation. A corporation, therefore, could not be indicted for a felony, because, if for no other reason, the punishment for felony is death or imprisonment, to neither of which penalties a corporation can be subjected. If the penalty prescribed for an offense is both fine and imprisonment, the statute cannot be applied to corporations in so far as regards the imprisonment, but the inability to punish by imprisonment does not prevent an indictment against a corporation and its punishment by fine.⁷⁷

§ 95. Liability for contempt of court.—A corporation may be guilty of a contempt of court, and punished therefor by fine.

Because of the fact that a corporation is impersonal, and cannot be attached,—that is, personally seized or taken,—it was at one time considered that a corporation could not be punished for contempt of court in disobeying or violating an injunction or other order or decree.⁷⁸ But courts now freely punish corporations for contempt in disobeying their orders or interfering with their proceedings. To punish one for contempt of court, attachment or seizure of the person is not necessary. The punishment may be by imposition of a fine. It is now well settled in most jurisdictions, therefore, that a corporation may be guilty of a contempt of court to the same extent and under the same circumstances as a natural person, and may be punished therefor by a fine, and the remedy is not, as was formerly thought, against its officers only.⁷⁹

See Little, *Punishment of a Corporation*, *The Standard Oil Case*, 3 *Illinois Law Rev.* 446.

⁷⁷ *Commonwealth v. Pulaski County Agricultural & Mechanical Ass'n*, 92 Ky. 197, 201, 17 S. W. 442; *State v. Belle Springs Creamery Co.*, 83 Kan. 389, 111 Pac. 474, L. R. A. 1915D 515; *State v. Salisbury Ice & Fuel Co.*, 166 N. C. 366, 81 S. E. 737, 52 L. R. A. (N. S.) 216, Ann. Cas. 1916C 456; *State v. Truax*, 130 Wash. 69, 226 Pac. 259, 33 A. L. R. 1206, 1211n (applicability of criminal statute to corporation as affected by character of punishment). See 18 *Green Bag* 253, 662.

⁷⁸ See *Mills' Case*, T. Raym. 152;

First Congregational Church of Bloomington v. City of Muscatine, 2 *Iowa* 69.

⁷⁹ *Golden Gate Consol. Hydraulic Min. Co. v. Yuba County Superior Court*, 65 Cal. 187, 3 Pac. 628; *City of New York v. New York & S. I. Ferry Co.*, 64 N. Y. 622; *West Jersey Traction Co. v. Board of Public Works of City of Camden*, 58 N. J. Law 536, 37 Atl. 578; *State ex rel. Fortney Lumber & Hardware Co. v. Baltimore & O. R. Co.*, 73 W. Va. 1, 79 S. E. 834; *Franklin Union No. 4 v. People*, 220 Ill. 355, 77 N. E. 176, 4 L. R. A. (N. S.) 1001, 110 Am. St. Rep. 248; *Lineker v. Dillon*, 275 Fed. 460.

The liability of a corporation for contempt of court is not limited to civil contempts to assist an injured suitor. It may be punished for a criminal contempt to vindicate the authority of the court, as for publishing an article in a newspaper, which is circulated in the place where a trial is pending, which is calculated to prejudice the jury and prevent a fair trial. A corporation may be proceeded against for criminal contempt, not only without indictment, but even without a formal complaint, upon the mere motion of the court against which the contempt has been committed.⁸⁰

§ 96. Corporations as "persons" within criminal statutes.—Corporations are within a statute enjoining or prohibiting an act or omission, and imposing a penalty for violation thereof, if they are within the intent and purpose of the statute, though they may not be expressly mentioned therein.

There are some cases in which the courts, applying the general rule that penal statutes are to be strictly construed, have held that a corporation is not within a statute imposing a penalty, unless it applies to them in express terms, or unless an intention on the part of the legislature to include them is obvious upon the face of the statute. According to this view, it was held, for example, that corporations were not included in a statute imposing a penalty upon the "owner, agent, or superintendent of any manufacturing establishment" who should employ children under a certain age in more than a certain number of hours' work per day.⁸¹ The general rule today is that corporations are included under the word "person," if they are within the spirit and purpose of the statute, and are subject to a prohibition against "any person" employing children under the age of 14 years in any mill or factory.⁸² But corporations are not always intended to be included by the word "person," which may appear from the context to refer

⁸⁰ *Telegram Newspaper Co. v. Commonwealth*, 172 Mass. 294, 52 N. E. 445, 44 L. R. A. 159, 70 Am. St. Rep. 280. In re Independent Pub. Co., 228 Fed. 787; *The King v. J. G. Hammond & Co., Ltd.*, [1914] 2 K. B. 866.

⁸¹ *Benson v. Monson & B. Mfg. Co.*, 9 Mete. (Mass.) 562. See also, *Cumberland & Oxford Canal Corp. v. City of Portland*, 56 Me. 77; *An-*

droscoggin Water Power Co. v. Bethel Steam Mill Co., 64 Me. 441; *State v. Cincinnati Fertilizer Co.*, 24 Ohio St. 611.

⁸² *Overland Cotton Mill Co. v. People*, 32 Colo. 263, 75 Pac. 924, 105 Am. St. Rep. 74. See *United States v. John Kelso Co.*, 86 Fed. 304; *State v. Belle Springs Creamery Co.*, 83 Kan. 389, 111 Pac. 474, L. R. A. 1915D 515.

to natural persons only.⁸³ "Corporations are to be considered as persons when the circumstances in which they are placed are identical with those of natural persons expressly included in a statute."⁸⁴

⁸³ *Standard Oil Co. v. State*, 117 Tenn. 618, 100 S. W. 705, 10 L. R. A. (N. S.) 1015; *Commonwealth v. Illinois Cent. R. Co.*, 152 Ky. 320, 324, 153 S. W. 459, 461, 45 L. R. A. (N. S.) 344, *Ann. Cas.* 1915B 617 (manslaughter).

⁸⁴ *Stewart v. Waterloo Turn Verein*, 71 Iowa 226, 32 N. W. 275, 60 Am. St. Rep. 786. See *United States v. Union Supply Co.*, 215 U. S. 50, 54 L. Ed. 87, 30 Sup. Ct. 15; *Pearks, Gunston & Tee v. Ward*, [1902] 2 K. B. 1, 20 Cox, C. C. 279.

CHAPTER IX.

AUTHORITY AND POWERS OF DIRECTORS AND OFFICERS.

I. POWERS OF DIRECTORS.

§ 97. In general.—When the articles or statutes intrust the directors with the management of the corporation, they have implied authority to bind the corporation by any act or contract which is within its express or implied powers, and which falls properly within its ordinary business. But they have no power, unless it is expressly conferred upon them, to make or consent to any fundamental change in the organization, charter, or powers of the corporation, or to do other acts not within its ordinary business.

Acts within the express or implied powers of the directors do not require the assent of the stockholders unless by express provision to such effect. But express charter or statutory provisions sometimes make the validity of particular acts of the directors dependent upon the assent of the stockholders, or of a certain proportion of them.

As a rule, the directors are intrusted generally with the management of the business of the corporation. When this is the case, they have the power to bind it by any contract which is within its express or implied powers, and which in their judgment is necessary or proper in order to carry out the objects for which the corporation was created, and, generally, to do or authorize any act which falls within the management of the ordinary business of the corporation.¹

A corporate body can only act by agents. The corporation itself can do no act, unless it be said that resolutions passed at

¹ Collier v. Consol. Ry. L. & R. Co., 70 N. J. L. 313, 57 Atl. 417; Park v. Grant Locomotive Works, 40 N. J. Eq. 114, 3 Atl. 162; Beveridge v. New York Elevated R. Co., 112 N. Y. 1, 19 N. E. 489, 2 L. R. A. 648; Hutchinson v. Green, 91 Mo. 367, 1 S. W. 853; Vanderpoel v. Gorman, 140 N. Y. 563, 35 N. E. 932, 24 L. R. A. 548, 37 Am. St. Rep. 601; Burrill v. Nahant Bank, 2

Metc. (Mass.) 163, 35 Am. Dec. 395; Saltmarsh v. Spaulding, 147 Mass. 224, 17 N. E. 316; Chase v. Tuttle, 55 Conn. 455, 12 Atl. 874, 3 Am. St. Rep. 64; Cleveland & M. R. Co. v. Himrod Furnace Co., 37 Ohio St. 321, 41 Am. Rep. 509; Bradford Belting Co. v. Gibson, 68 Ohio St. 442, 67 N. E. 888; Fletcher, Corporations, sec. 1961.

stockholders' meetings are determinations of the corporate principal. But the corporate will even when thus declared must be executed by agents. Directors are the chief administrators to whom as a board are delegated the power and duty of managing the general affairs of the company. "All powers," said the court of appeals of New York, "directly conferred by statute, or impliedly granted, of necessity, must be exercised by the directors who are constituted by the law as the agency for the doing of corporate acts. The expression of the corporate will and the performance of corporate functions, in the management of a corporation, may originate with its directors, where the law or the by-laws have not expressly restricted their authority and made their action to rest for its validity upon the concurrence of the stockholders, by previous action or subsequent ratification. Within the chartered authority they have the fullest power to regulate the concerns of the corporation, according to their best judgment, and contracts, which the corporation could legitimately make, come within the scope of the ordinary powers of corporate management."²

The board of directors and not the stockholders is the original and supreme authority to make corporate contracts, and all executive acts should be traced back, in the absence of statute, to the directors. Thus the directors or trustees of a corporation have the power to borrow money when it is needed in the business of the corporation, and to execute or authorize the execution of negotiable notes or bonds to secure the same;³ to pledge or mortgage the property of the corporation, real or personal, to secure the payment of money borrowed for the legitimate purposes of the corporation, or to secure any other debt lawfully contracted;⁴ to sell the real estate of a corporation when it is authorized to buy and sell real estate; without the consent of the stockholders;⁵ to execute or authorize an assignment of all the property of the corporation, for

² *Beveridge v. New York El. R. Co.*, 112 N. Y. 1, 19 N. E. 489, 2 L. R. A. 648; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112, Ann. Cas. 1914A 777; *Elggren v. Woolley*, 64 Utah 183, 228 Pac. 906.

³ *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163, 35 Am. Dec. 395; *Saltmarsh v. Spaulding*, 147 Mass. 224, 17 N. E. 316.

⁴ *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163, 35 Am. Dec. 395; *Saltmarsh v. Spaulding*, 147 Mass. 224,

17 N. E. 316; *Ashton v. Lehigh Coal & Navigation Co.*, 49 Pa. St. 261; *Hoyt v. Thompson's Ex'r*, 19 N. Y. 207; *Thompson v. Natchez Water & Sewer Co.*, 68 Miss. 423, 9 So. 821; *Blood v. La Serena Land & Water Co.*, 113 Cal. 221, 41 Pac. 1017, 45 Pac. 252; *Hartley v. Ault Woodenware Co.*, 82 W. Va. 780, 97 S. E. 137; *Wood v. Whelen*, 93 Ill. 153.

⁵ *Hendren v. Neepor*, 279 Mo. 125, 213 S. W. 839, 5 A. L. R. 927, 930n.

the benefit of its creditors, when such a step is necessary or advisable,⁶ to make or authorize a lease of a part or all of the property of the corporation, when necessary or advisable, if the power to make the lease is conferred upon the corporation by its charter;⁷ to make calls or assessments upon subscriptions to the capital stock, and to determine the necessity therefor;⁸ and to determine whether the condition of the company is such as to warrant the payment of dividends.⁹

The authority of the directors or trustees is restricted to the management of the regular business affairs of the corporation, unless more extensive power is expressly conferred. Their authority does not extend to changes in the character or organization of the corporation, or to a winding up of the corporation, etc., unless by express provision, for such matters do not relate to ordinary business.¹⁰ A general provision in the charter of a corporation or the general law, that "*all the corporate powers* shall be vested in and exercised by a board of directors, and such officers and agents as said board shall appoint," refers merely to the ordinary business transactions of the corporation, and does not extend to other acts which are not ordinarily within the powers of the directors, but are done or authorized by the stockholders only,—as the reconstruction of and fundamental changes in the corporate body, increase of the capital stock, etc.¹¹ Thus, as a general rule, the directors or trus-

⁶ *Hutchinson v. Green*, 91 Mo. 367, 1 S. W. 853; *Calumet Paper Co. v. Haskell Show Printing Co.*, 144 Mo. 331, 45 S. W. 1115, 66 Am. St. Rep. 425; *Sargent v. Webster*, 13 Metc. (Mass.) 497, 46 Am. Dec. 743; *Buell v. Buckingham*, 16 Iowa 284, 85 Am. Dec. 516; *Chase v. Tuttle*, 55 Conn. 455, 12 Atl. 874, 3 Am. St. Rep. 64; *Boynton v. Roe*, 114 Mich. 401, 72 N. W. 257; *Goetz v. Knie*, 103 Wis. 366, 79 N. W. 401; *Vanderpoel v. Gorman*, 140 N. Y. 563, 35 N. E. 932, 24 L. R. A. 548, 37 Am. St. Rep. 601; *Rogers v. Pell*, 154 N. Y. 518, 49 N. E. 75. See *In re DeCamp Glass Casket Co.*, 272 Fed. 558.

⁷ *Beveridge v. New York El. R. Co.*, 112 N. Y. 1, 19 N. E. 489, 2 L. R. A. 618; *Hennessy v. Muhleman*, 40 App. Div. (N. Y.) 175, 57 N. Y. Supp. 854, rev'g 27 N. Y. Misc. 232, 57 N. Y. Supp. 114. Compare, however, *Metropolitan El. Ry. Co. v. Manhattan El. Ry. Co.*, 11

Daly (N. Y.) 373, 14 Abb. N. C. 103.

⁸ *Oglesby v. Attrill*, 105 U. S. 605, 26 L. Ed. 1186; *Millaudon v. New Orleans & Carrollton R. Co.*, 3 Rob. (La.) 488; *Smits v. Natchez Steamboat Co.*, 1 How. (Miss.) 479; *Rutland & Burlington R. Co. v. Thrall*, 35 Vt. 536.

⁹ *McNab v. McNab & Harlin Mfg. Co.*, 62 Hun (N. Y.) 18, 16 N. Y. Supp. 448, aff'd 133 N. Y. 687, 31 N. E. 627; *New York, L. E. & W. R. Co. v. Nickals*, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; *Pratt v. Pratt, Read & Co.*, 33 Conn. 446; *Wilson v. American Ice Co.*, 206 Fed. 736.

¹⁰ *Chicago City Ry. Co. v. Allerton*, 18 Wall. (U. S.) 233, 21 L. Ed. 902; *Metropolitan El. Ry. Co. v. Manhattan El. Ry. Co.*, 11 *Daly (N. Y.)* 373, 14 Abb. N. C. 103, and other cases in the notes following.

¹¹ *Chicago City Ry. Co. v. Allerton*, 18 Wall. (U. S.) 233, 21 L. Ed.

tees of a corporation have no implied authority to accept an amendment of the charter of the corporation;¹² or to increase or reduce the capital stock of the corporation;¹³ or to consolidate with another corporation;¹⁴ or to surrender the charter or wind up and dissolve the corporation;¹⁵ or to sell out all the property of the corporation so as to virtually end its existence, and prevent it from carrying on its business;¹⁶ or to make, alter, or repeal by-laws, unless such power is expressly conferred;¹⁷ or to release subscribers for stock otherwise than in pursuance of a *bona fide* compromise, or for a sufficient consideration.¹⁸

The certificate of incorporation of the Standard Oil Company of California, organized under the laws of Delaware, provides as to

902; *Eidman v. Bowman*, 58 Ill. 444, 11 Am. Rep. 90. See also, *In re Baker's Appeal*, 109 Pa. St. 461; post, sec. 175.

¹² *Marlborough Mfg. Co. v. Smith*, 2 Conn. 579; *Com. v. Cullen*, 13 Pa. St. 133, 53 Am. Dec. 450; *In re Baker's Appeal*, 109 Pa. St. 461; *State ex rel. Brun v. Oftedal*, 72 Minn. 498, 75 N. W. 692; *Allen v. White*, 103 Neb. 256, 171 N. W. 52.

¹³ *Chicago City Ry. Co. v. Allerton*, 18 Wall. (U. S.) 233, 21 L. Ed. 902; *Eidman v. Bowman*, 58 Ill. 444, 11 Am. Rep. 90; *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546; *Humboldt Driving Park Ass'n v. Stevens*, 34 Neb. 528, 52 N. W. 568, 33 Am. St. Rep. 654; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203.

¹⁴ *Blatchford v. Ross*, 54 Barb. (N. Y.) 42, 37 How. Pr. 110.

¹⁵ *Ernest v. Nicholls*, 6 H. L. Cas. 401; *Ward v. Sea Ins. Co.*, 7 Paige (N. Y.) 294; *Abbot v. American Hard Rubber Co.*, 33 Barb. (N. Y.) 578; *Balliet v. Brown*, 103 Pa. St. 546; *Rollins v. Clay*, 33 Me. 132; *Jones v. Bank of Leadville*, 10 Colo. 464, 17 Pac. 272.

But such authority may be conferred. *Wallamet Falls Canal & Lock Co. v. Kittridge*, 5 Sawy. 44, Fed. Cas. No. 17105.

In Commercial Nat. Bank v. Weinhard, 192 U. S. 243, 48 L. Ed. 425, 24 Sup. Ct. 253, it is held that where the statute confers an election upon a national bank either to wind up the bank or to make good the deficiency of capital by an assessment, that the shareholders have the right

to decide which course to pursue, and an assessment voted by the directors without action by the stockholders is void.

¹⁶ *Ernest v. Nicholls*, 6 H. L. Cas. 401; *Hartmann v. Masters*, 269 Fed. 483; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Consolidated Water Power Co. v. Nash*, 109 Wis. 490, 85 N. W. 485; *Forrester v. Butte & M. Consol. Copper & Silver Min. Co.*, 21 Mont. 544, 55 Pac. 229, 353, s. c., 29 Mont. 397, 76 Pac. 211, 74 Pac. 1088; *Elyton Land Co. v. Dowdell*, 113 Ala. 177, 20 So. 981, 59 Am. St. Rep. 105.

But they may sell the property of the corporation, if necessary, to pay its debts. *McElroy v. Minnesota Percheron Horse Co.*, 96 Wis. 317, 71 N. W. 652; *Union Trust Co. v. Carter*, 139 Fed. 717.

¹⁷ *Thayer v. Herrick*, Fed. Cas. No. 13868; *Albers v. Merchants' Exchange of St. Louis*, 39 Mo. App. 583; *Watson v. Sidney F. Woody Printing Co.*, 56 Mo. App. 145; post, § 178.

Such authority, however, may be expressly conferred. *Heintzelman v. Druids' Relief Ass'n*, 38 Minn. 138, 36 N. W. 100; *Stevens v. Davison*, 18 Grat. (Va.) 819, 98 Am. Dec. 692.

¹⁸ *In re Esparto Trading Co.*, 12 Ch. Div. 191; *Sawyer v. Hoag*, 17 Wall. (U. S.) 620, 21 L. Ed. 735; *Bedford R. Co. v. Bowser*, 48 Pa. St. 29; *Tuckerman v. Brown*, 33 N. Y. 297, 88 Am. Dec. 386; *Rider v. Morrison*, 54 Md. 429; *La Fayette County Monument Corp. v. Ryland*, 80 Wis. 29, 49 N. W. 157.

the powers of directors, "in furtherance and not in limitation of the powers conferred by statute, the board of directors is expressly authorized:

- (a) To make and alter the by-laws of this corporation, without any action on the part of the stockholders, but the by-laws made by the directors and the powers so conferred may be altered or repealed by the directors or stockholders.
- (b) To fix, determine, and vary the amount to be maintained as surplus, and subject to the other provisions and requirements of this certificate of incorporation the amount or amounts to be set apart or reserved as working capital.
- (c) By resolution passed by a majority of the whole board, to designate three or more of their number to constitute an executive committee, which committee, to the extent provided in said resolution or in the by-laws of this corporation, shall have and exercise (except when the board of directors shall be in session) any and all of the powers of the board of directors and the management of the business and affairs of this corporation and have power, to authorize the seal of this corporation to be affixed to all papers which may require it.
- (d) To authorize and cause to be executed mortgages and liens, without limit as to amount, on the real and personal property of this corporation.
- (e) To sell, exchange, assign, convey or otherwise dispose of a part of the property, assets and effects of this corporation less than the whole or less than substantially the whole thereof, on such terms and conditions as they shall deem advisable without the assent of the stockholders in writing or otherwise.
- (f) With the consent in writing of, or pursuant to a vote of, the holders of a majority of the number of shares of capital stock issued and outstanding to sell, exchange, assign, transfer and convey or otherwise dispose of the whole, or substantially the whole of the property, assets, effects and good will of this corporation (including the corporate franchise and other intangible property of this corporation) upon such terms and conditions as the board of directors shall deem expedient and for the best interests of this corporation.

- (g) From time to time to determine whether and to what extent and at what time and place and under what conditions and regulations the accounts and books of this corporation, or any of them, shall be open to the inspection of any stockholder; and no stockholder shall have any right to inspect any account, book or document of this corporation except as conferred by statute or the by-laws or as authorized by resolution of the stockholders or board of directors."

Such an extreme delegation of power would not be valid under the laws of many states.

§ 98. Requirement of assent of stockholders.

Sometimes, for the better protection of the stockholders, their assent, or the assent of a certain proportion of them, is expressly required by the charter or general law to validate acts by the directors or trustees, which, except for such requirement, would fall properly within their powers. Thus, the statutes sometimes require that mortgages, increase of bonded indebtedness, conveyance of land, or other transactions by a corporation must receive the assent, or the written assent, of the holders of a majority of the stock, or of two-thirds of the stock, and in such a case, as against stockholders who may object, the directors or trustees cannot act without such assent of the stockholders given in substantial compliance with the provisions of the statute.¹⁹

In most of the states in which the question has arisen, if not in all, statutes requiring the written assent of stockholders to a mortgage, or other act, or their assent at a general meeting, are construed as intended for their protection and benefit only, and it has been held that they can attack the mortgage only for want of such assent; that, if they acquiesce, neither creditors of the corporation nor the corporation itself can complain.²⁰ If a corporation receives

¹⁹ See *Forbes v. San Rafael Turnpike Co.*, 50 Cal. 340; *Parker v. Carolina Savings Bank*, 53 S. C. 583, 31 S. E. 673, 69 Am. St. Rep. 888; *The Allianca*, 73 Fed. 452; *Vail v. Hamilton*, 85 N. Y. 453; *Lord v. Yonkers Fuel Gas Co.*, 99 N. Y. 547; *Welch v. Importers' & Traders' Nat. Bank*, 122 N. Y. 177, 25 N. E. 269; *Thomas v. Citizens' Horse Ry. Co.*, 104 Ill. 462; *Nelson v. Hubbard*, 96 Ala. 238, 11 So. 428.

²⁰ *Barrett v. Pollak Co.*, 108 Ala. 390, 18 So. 615, 54 Am. St. Rep. 172; *Alabama Iron & Steel Co. v. McKeever*, 112 Ala. 134, 20 So. 84; *Hervey v. Illinois Midland Ry. Co.*, 28 Fed. 169; *Galbraith v. Shasta Iron Co.*, 143 Cal. 94, 76 Pac. 901; *Nelson v. Hubbard*, 96 Ala. 238, 11 So. 428, 17 L. R. A. 375; *United States Industrial Alcohol Co. v. Distilling Co.*, 89 N. J. Eq. 177, 104 Atl. 216.

and retains the consideration for a mortgage, it and its stockholders may be estopped to set up want of consent of stockholders.²¹

§ 99. Power of stockholders to control the acts of directors.

It is generally held that if the stockholders attempt to exercise powers which by statute or charter are lodged in the directors, their action is void. They have not the power by a resolution passed by a majority of their number to order the directors to make an agreement for the sale of the entire assets of the company, notwithstanding that the directors may consider the sale improvident.²² In general the management and control of the company are vested in the directors, and their decisions cannot be overruled by the stockholders. Stockholders cannot require directors to act or advise with a committee elected by them to assist in the conduct of its affairs, where the statute entrusts the management of the business to the directors.²³ The directors need not follow the wishes or resolutions of the stockholders. An agreement among stockholders that contemplates the selecting of dummy directors who shall remain passive or subservient to the will of one or more of the parties in the management of the corporation is illegal and void, and good faith does not cure its illegality. The directors hold office charged with the duty to act for the corporation according to their

²¹ *Hamilton Trust Co. v. Clemes*, 17 N. Y. App. Div. 152, 45 N. Y. Supp. 141; *Texas Western Ry. Co. v. Gentry*, 69 Tex. 625, 8 S. W. 98.

²² *Automobile Self-Cleansing Filter Co. v. Cuninghame*, [1906] 2 Ch. Div. 34. See 19 *Harvard Law Rev.* 620; 11 *Cornell Law Quarterly* 82. Compare *Marshall's Valve Gear Co., Ltd. v. Manning, etc.*, Ch. Div. [1909] 1 Ch. 267 (held, that majority shareholders had the right to control action of directors and decide that suit should proceed in the name of the company). See *Palmer's Company Law* (11th Ed.), p. 194. This case can only stand with previous cases on the ground that it was a case of fraud. See note, 22 *Harvard Law Rev.* 303.

Machen, Corporations, sec. 1440, says: "It seems clear on principle that shareholders may lawfully take into their own hands the most minute details of the company's business." This would not seem to be generally the law. But see *Union Pac. R. Co. v. Chicago, R. I. & P.*

R. Co., 163 U. S. 564, 595, 600, 41 L. Ed. 265, 16 Sup. Ct. 1173 (charter vested management in the stockholders, who by by-laws create a board of directors). *Gross Iron Ore Co. v. Paulle*, 132 Minn. 160, 156 N. W. 268.

²³ *Charlestown Boot & Shoe Co. v. Dunsmore*, 60 N. H. 85. See *Fleischer v. Pelton Steel Co.*, 183 Wis. 451, 198 N. W. 444; *Lawrence v. Washington-Detroit Theatre Co.*, 190 Mich. 44, 155 N. W. 738; 3 *Fletcher, Corporations*, secs. 1733, 4065; *Manson v. Curtis*, 223 N. Y. 313, 323, 119 N. E. 559, Ann. Cas. 1918E 247. "As a general rule the stockholders cannot act in relation to the ordinary business of the corporation, nor can they control the directors in the exercise of the judgment vested in them by virtue of their office." *People ex rel. Manice v. Powell*, 201 N. Y. 194, 94 N. E. 634; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112, Ann. Cas. 1914A 777.

best judgment, and in so doing they cannot be controlled in the reasonable exercise of their discretion and the performance of their duty for the benefit of all concerned.^{23a}

Stockholders are too numerous, too scattered and too unfamiliar with the business of the corporation to conduct its business directly. It is accordingly the plan of corporate organization that the stockholders shall choose directors who shall control and supervise the conduct of the business. Each member of the board is supposed to give reasonable attention to the company's affairs. The stockholders, in general, have no voice in controlling the business policies except through the election of directors. As the Ohio court says:²⁴ "The individual directors are in no sense the personal representatives of the stockholders by whose suffrage they hold office. However much they might be influenced by the wisdom and wishes of the stockholders, it remains their duty to exercise their own judgment in all final corporate action. If the action of the board of directors does not express the will and wish of the majority of the shares of stock, the majority has its remedy by retiring the members . . . at the regular time for election of directors."

It may well be contended, however, that where the stockholders unanimously vote that certain action be taken, this should control the discretion of the directors. The right to have the affairs of the corporation managed by the board of directors is a right of each shareholder derived from the agreement by which the company is formed. Directors have no personal interest in their official acts. If the real parties in interest unanimously agree on certain corpo-

^{23a} *Manson v. Curtis*, 223 N. Y. 313, 119 N. E. 559, Ann. Cas. 1918E 247; *Seitz v. Michel*, 148 Minn. 80, 181 N. W. 102, 12 A. L. R. 1060. See 23 Harvard Law Rev. 551, note, on control of directors under partnership agreement among shareholders. In *Read v. Broadway Theatre Co.*, — N. J. Eq. —, 132 Atl. 480, it is said: "Complainant attempts to bring this case within the rule of *Jackson v. Hooper*, 76 N. J. Eq. 592, 75 Atl. 568, 27 L. R. A. (N. S.) 658, but in my judgment that rule has no application here. In that case there was an agreement between the two stockholders owning all the stock of the corporation that the corporation should be treated and conducted as a partnership, and that the directors other than these two

parties should be merely nominal directors and have no control whatever of the business of the company. The Court of Errors and Appeals held that a court of equity has no power to take corporate property into its control as upon the dissolution of a partnership, but that the rights of the parties must be administered as shareholders in the corporation and not as partners, and that the agreement that the so-called 'dummy' directors should have no voice in the management of the company's affairs was unenforceable." *Reade v. Broadway Theatre Co.*, — N. J. —, 132 Atl. 477, 480. See also, *Boag v. Thompson*, 208 N. Y. App. Div. 132, 203 N. Y. Supp. 395, 398, 399.

²⁴ *Lamb v. Lehmann*, 110 Ohio St. 59, 143 N. E. 276.

rate acts, their voice should control. But a mere majority cannot take away the right of the minority to the directors' discretion.²⁵ It is sometimes held that a mere majority vote of the stockholders may bind the corporation by ratification of an unauthorized contract when it could not bind it by original authorization.^{25a}

§ 100. Necessity for action as a board.—As a general rule, when the directors or trustees of a corporation are authorized to do a particular act, or are intrusted generally with the management of the corporation, they cannot act individually, so as to bind the corporation, but must act as a board at a legal meeting.

By the weight of authority, when the power to do particular acts, or general authority to manage the affairs of the corporation, is vested in the directors or trustees, it is vested in them, not individually, but as a board. As a general rule, they can act so as to bind the corporation only when they act as a board and at a legal meeting. If they act or give their consent separately, and not as a board, or if they act at a meeting which is not a legal meeting, as hereafter explained, their action is not the action of the corporation, although all may consent, and the corporation is not bound, in the absence of ratification or estoppel.²⁶ The law proceeds upon

²⁵ See note, Right of shareholders to control the acts of directors, 11 Cornell Law Quarterly 82; Fitzpatrick v. O'Neil, 43 Mont. 552, 118 Pac. 273, Ann. Cas. 1912C 296, 300 note, necessity of action by directors to validate corporate act.

Informal action by all the stockholders may bind the corporation. Kentucky Coal Lands Co. v. Mineral Development Co., 295 Fed. 255; Suduth v. Storm King Coal Co., 263 Fed. 433. See 15 Michigan Law Rev. 264; Computing Scale Co. v. Toledo Computing Scale Co., 279 Fed. 648, 674.

In *Murphy v. W. H. & F. W. Cane, Inc.*, 82 N. J. Law 557, 82 Atl. 854, Ann. Cas. 1913D 643, Pitney, C., says: "Where the functions normally pertaining to the board of directors are in the particular instance performed by the stockholders themselves, they by common consent dispensing with the election of directors, the agency for the company may result as clearly as if action by a board of directors had intervened, for such directors would be no more than agents for the body of stock-

holders." But see *Gashwiler v. Willis*, 33 Cal. 11, 91 Am. Dec. 607; *Hotaling v. Hotaling*, 193 Cal. 363, 224 Pac. 455 (a meeting of stockholders is wholly incompetent to authorize a corporate act, such as a conveyance, and stockholders cannot ratify what they cannot authorize); *Blood v. La Serena Land & Water Co.*, 113 Cal. 221, 226, 41 Pac. 1017, 45 Pac. 252; *Bassett v. Fairchild*, 132 Cal. 637, 647, 64 Pac. 1082, 52 L. R. A. 611.

^{25a} *Respass v. Rex Spinning Co.*, 191 N. C. 809, 133 S. E. 391 (action for services in auditing, authorized by resolution of stockholders at annual meeting. The report was accepted at a later meeting. Held, a ratification by the stockholders even if the directors had not authorized the committee to employ the plaintiffs. As the contract was not *ultra vires*, it was not beyond the power of corporate ratification by a majority vote of those present at a legal meeting, even if some stockholders were absent.

²⁶ *Edgerly v. Emerson*, 23 N. H. 555, 55 Am. Dec. 207; *Pauly v.*

the theory that the directors shall meet and counsel with each other, and that any determination affecting the corporation shall only be arrived at and expressed after a consultation at a meeting of the board attended by at least a majority of its members.²⁷ The stockholders are entitled to the advantage coming from their combined wisdom, knowledge and business foresight, giving efficiency and safety to the corporate management.

It has been said that "the general rule seems to rest upon two reasons: First, that collective action is necessary in order that the act may be deliberately adopted, after opportunity for discussion and an interchange of views; and second, that the directors are, for the purpose of managing the affairs of the corporation, the agents of the stockholders, and are given no power to act otherwise than as a board."²⁸ Thus, it has been held that a conveyance of land of a corporation, not authorized by the directors as a board, but signed by all of them separately, although it is in the name of the corporation, is not good, either as a conveyance by the corporation, or as a contract to convey. The power to sell and convey could only be conferred by the directors when assembled and acting as a board at a directors' meeting. It has been held insufficient to

Pauly, 107 Cal. 8, 40 Pac. 29, 48 Am. St. Rep. 98; Gashweiler v. Willis, 33 Cal. 11, 91 Am. Dec. 607; First Nat. Bank of Ft. Scott v. Drake, 35 Kan. 564, 11 Pac. 445, 57 Am. Rep. 193; Pierce v. Morse-Oliver Building Co., 94 Me. 406, 47 Atl. 914; Calumet Paper Co. v. Haskell Show Printing Co., 144 Mo. 331, 45 S. W. 1115, 66 Am. St. Rep. 425; First Nat. Bank of Highstown v. Christopher, 40 N. J. Law 435, 29 Am. Rep. 262; West Jersey Traction Co. v. Camden Horse R. Co., 53 N. J. Eq. 163, 35 Atl. 49; Limer v. Traders Co., 44 W. Va. 175, 28 S. E. 730; Hotaling v. Hotaling, 193 Cal. 368, 224 Pac. 455; Barton v. School Dist., 77 Ore. 30, 150 Pac. 251, Ann. Cas. 1917A 252; Pink v. Metropolitan Milk Co., 129 Minn. 353, 152 N. W. 725.

In *Jackson v. Bonneville Irr. Dist.*, — Utah —, 243 Pac. 107, 111, it is said: "While we are not inclined to hold that the acts of a corporation can be proven only by the official minutes of the board, we, nevertheless, understand the rule to be that in order to bind the corporation the board must act, and act as a board either in a regular session

or in a special session called for the purpose. A rigid adherence to the rule has no doubt been productive of hardship in many cases, but a disregard of the rule would result in endless confusion and be productive of far greater mischief than a rigid application." See also, Dec. Dig. Corporations, sec. 298 (1).

²⁷First Nat. Bank of Ft. Scott v. Drake, 35 Kan. 564, 11 Pac. 445, 57 Am. Rep. 193; Ames v. Goldfield Merger Mines Co., 227 Fed. 292, 301; Sargent & Co. v. Heggen, 195 Iowa 361, 190 N. W. 506; Lawrence v. Montgomery Gas Co., 88 W. Va. 352, 106 S. E. 890.

A provision in the charter that action by the board of directors may be taken by a resolution signed by all the directors the same as if duly passed at a regular meeting of the board, was held unauthorized and void, as overthrowing a safeguard required by law. *Audenried v. East Coast Milling Co.*, 68 N. J. Eq. 450, 59 Atl. 577.

²⁸*Gerard v. Empire Square Realty Co.*, 195 N. Y. App. Div. 244, 187 N. Y. Supp. 306.

authorize execution of a deed that the directors were present in a stockholders' meeting and voted to sell the property and also signed the deed individually.²⁹ The same is true of an assignment for the benefit of creditors authorized by the directors separately, and not as a board,³⁰ and of a mortgage.³¹ The technical rule that requires the formality of authorization by a meeting of the board of directors duly assembled as such is being gradually eaten away by exceptions, and seems rather impractical in view of the informal way in which business is usually carried on.

There is, indeed, respectable support for the view that the consent of all the directors will be sufficient to bind the corporation without any formal meeting as a board or even, in some cases, the consent of a majority, though acting separately.³² The necessity for directors to act as a board and at a meeting is based upon their duty to the stockholders; and the stockholders and the corporation, therefore, may be estopped to deny the validity of their action. For this reason, it has been held that the general rule does not apply where it is the custom or usage of the directors to act separately, and not as a board.³³ If the directors own all the stock, a

²⁹ *Baldwin v. Canfield*, 26 Minn. 43, 61, 1 N. W. 261, 276. See *Hotaling v. Hotaling*, 193 Cal. 368, 224 Pac. 455; *Gashwiler v. Willis*, 33 Cal. 11, 91 Am. Dec. 607. In *Gashwiler v. Willis*, it is held that the power to sell and convey real property can be conferred only by the board of directors when assembled and acting as such. The stockholders of a corporation have no power to authorize the sale of the corporate property or the execution of a deed, even if all the directors are present and assent thereto.

³⁰ *Calumet Paper Co. v. Haskell Show Printing Co.*, 144 Mo. 331, 45 S. W. 1115, 66 Am. St. Rep. 425.

³¹ *Dennison v. Austin*, 15 Wis. 334, 336; *Blood v. LaSerena*, 113 Cal. 221, 41 Pac. 1017, 45 Pac. 252; *Alta Silver Min. Co. v. Alta Placer Min. Co.*, 78 Cal. 629, 21 Pac. 373; *Duke v. Markham*, 105 N. C. 131, 10 S. E. 1017, 18 Am. St. Rep. 889. But see *Merchants' & Farmers' Bank v. Harris Lumber Co.*, 103 Ark. 283, 146 S. W. 508, Ann. Cas. 1914B 713, 715 note; *Garmany v. Lawton*, 124 Ga. 876, 53 S. E. 669, 2 L. R. A. (N. S.) 828; *Gross Iron Ore Co. v. Paulle*, 132 Minn. 160, 156 N. W. 268.

³² *National State Bank v. Sanford Fork & Tool Co.*, 157 Ind. 10, 60 N. E. 699; *Magowan v. Groneweg*, 16 S. D. 29, 91 N. W. 335; *Stablein v. Gemeinde*, 45 S. D. 518, 189 N. W. 312; *Gorrill v. Greenlees*, 104 Kan. 693, 180 Pac. 798; *Baker v. Smith*, 41 R. I. 17, 102 Atl. 721; *Buckley v. Jennings*, 95 Vt. 205, 114 Atl. 40.

Casual meeting of directors as a meeting of the board, *Barron v. Potter*, 7 B. R. C. 383; *Pacific State Bank v. Coats*, 205 Fed. 618, Ann. Cas. 1913E 846.

³³ *Longmont Supply Ditch Co. v. Coffman*, 11 Colo. 551, 19 Pac. 508; *Bank of Middlebury v. Rutland & Washington R. Co.*, 30 Vt. 159; *Baker v. Smith*, 41 R. I. 17, 102 Atl. 721; *Kozy Theatre Co. v. Love*, 191 Ky. 595, 231 S. W. 249.

That corporation may be bound in various ways without any action of its board of directors, see *First Trust Co. v. Miller*, 160 Wis. 336, 151 N. W. 813 (custom of doing business through agent; acquiescence; retaining fruits of transaction; estoppel). *American Nat. Bank v. Wheeler-Adams Co.*, 31 S. D. 524, 141 N. W. 396.

conveyance, mortgage, or contract authorized by them when not assembled at a meeting is valid.³⁴ It has been held that the stockholders may waive the necessity for a meeting of the board of directors, and without such meeting may authorize acts to be done by agents of the corporation or ratify acts done and bind the corporation. The shareholders own the assets and, in fact, constitute the corporation, and the rule requiring directors' meetings to authorize acts is for their benefit.³⁵

Where the shareholders of a corporation, by acquiescence, invest the executive officers of the company with the powers and functions of the board of directors as the usual method of conducting the business, the board being inactive and the officers discharging all their duties, the acts of such officers will bind the corporation according to some courts, although not authorized by any vote of either shareholders or directors.³⁶ The corporation may be estopped, as against an innocent third person, to deny the validity of a mortgage or other act done or authorized by the directors separately, or otherwise than at a legal meeting by long acquiescence or receipt of benefits.³⁷ There are many cases which hold that where a single stockholder owns substantially all the stock of the corporation he may bind the corporation by his acts without resolu-

³⁴ *Jordan v. Collins*, 107 Ala. 572, 18 So. 137. And see *Teitig v. Boesman Bros. & Co.*, 12 Mont. 404, 31 Pac. 371; *Kozy Theatre Co. v. Love*, 191 Ky. 595, 231 S. W. 249; *Gerard v. Empire Square Realty Co.*, 195 N. Y. App. Div. 244, 187 N. Y. Supp. 306; *Steeple v. Max Kumer Co.*, 121 Wash. 47, 208 Pac. 44.

³⁵ *Merchants' & Farmers' Bank v. Harris Lumber Co.*, 103 Ark. 283, 146 S. W. 508, Ann. Cas. 1914B 713; *Morisette v. Howard*, 62 Kan. 463, 63 Pac. 756; 2 *Morawetz, Corporations*, sec. 623; *Fitzpatrick v. O'Neill*, 43 Mont. 552, 118 Pac. 273, Ann. Cas. 1912C 296, 300, 302. Though Montana Code requires corporate action to be executed by a board of directors, issuance of stock by unanimous consent of stockholders at meeting is valid.

³⁶ *Garmany v. Lawton*, 124 Ga. 876, 53 S. E. 669; *Cunningham v. German Ins. Bank*, 101 Fed. 977; *Galbraith v. First Nat. Bank*, 221 Fed. 386; *Gross Iron Ore v. Paulle*, 132 Minn. 160, 156 N. W. 268; 15

Mich. Law Rev. 264; *Barkin Const. Co. v. Goodman*, 221 N. Y. 156, 116 N. E. 770: "In the daily conduct of its affairs there was no one except the secretary who assumed to speak for it. If he was not the manager, the company had none."

In another New York case it is said: "We must recognize the fact that to a greater and greater degree all business, great and small, is being brought under the management of corporations instead of partnerships; and they are in perhaps the majority of instances conducted by officers and directors little informed in the law of corporations, who often act informally, sometimes without meetings or even by-laws." *Gerard v. Empire Square Realty Co.*, 195 App. Div. 244, 187 N. Y. Supp. 306.

³⁷ *Tenney v. East Warren Lumber Co.*, 43 N. H. 343; *Luitwieler v. Luitwieler Co.*, 67 Cal. App. 544, 228 Pac. 398; *McCormick Saeltzer Co. v. Grizzley Creek Lumber Co.*, — Cal. App. —, 240 Pac. 32.

tion of the board of directors.³⁸ This is usually put on the ground of disregarding the separate corporate entity, but may better be explained as a liberalized agency doctrine and a dispensing with the formalities of usual corporate procedure where they can serve no useful purpose.

§ 101. Delegation of authority by directors and other officers.—Directors are impliedly authorized to appoint subordinate officers and agents, and delegate to them the power to do any act which is necessary or proper in the usual course of business of the corporation.

The subordinate officers or agents of a corporation cannot delegate their powers, in so far as they involve the exercise of judgment or discretion, unless expressly or impliedly authorized to do so; but, in the absence of restrictions, managing officers and agents have implied authority to appoint and delegate powers to subordinate agents.

A corporation must of necessity act through agents and representatives. The board of directors may be designated as the primary agents, whose powers may be as extensive as the objects and purposes of the corporation require. All other agents receive their authority by delegation, express or implied, from these primary agents. Sometimes the powers of the directors do not extend to all the powers of the company, and acts *intra vires* of the company, may be beyond the authority of the directors without authorization from the stockholders acting in a general meeting. The doctrine that an agent cannot delegate his powers does not apply where he is authorized to do so, either expressly or impliedly. The directors or trustees of a corporation, therefore, can certainly delegate authority to act for and represent the corporation to subordinate officers and agents, even in matters involving the exercise of judgment and discretion, when they are expressly authorized to do so by appointment of committees and subordinate officers and agents.³⁹ And even in the absence of express authority, an authority to delegate powers to a large extent must be implied from necessity and

³⁸ *Wenban Estate, Inc. v. Hewlett*, 193 Cal. 675, 227 Pac. 723. Acts of sole stockholder bound corporation, though not done in the corporate name or by authority of the board of directors. See 13 California Law Rev. 235; *McCormick Saeltzer Co. v. Grizzly Creek Lumber Co.*, Cal. App. —, 240 Pac. 32.

³⁹ *Union Pac. Ry. Co. v. Chicago, R. I. & P. R. Co.*, 163 U. S. 564, 41 L. Ed. 265, 16 Sup. Ct. 1173, *aff'g* 51 Fed. 309; *Sheridan Electric Light Co. v. Catham Nat. Bank*, 127 N. Y. 517, 28 N. E. 467.

usage, for the directors or trustees cannot attend to all the details and current business of the corporation, and it is not customary for them to do so.

Where the charter, general law, or a by-law vests the general superintendence and control and active management of all the concerns of a corporation in a board of directors or trustees, as is generally the case in business corporations, the board constitute, for all purposes of dealing with others, the corporation, and do not, at least in the general management of the corporate business, exercise a delegated authority in the sense of the rule prohibiting delegation of authority by an agent; and it has been held, therefore, that they have authority, acting as and for the corporation, to delegate to subordinate officers or agents, or to a committee of their own number, the power to perform any act, in the course of the business of the corporation, which they themselves can legally perform, although the performance of the act may involve the exercise of the highest judgment and discretion.⁴⁰

The power of a board of directors to delegate authority to agents is sometimes explained on the ground that their powers are in a sense original, as if they were themselves principals.⁴¹ Such a theory is entirely needless to explain the power to appoint subordinate agents. Directors are general managers with plenary powers, and their authority clearly includes power to appoint other agents, such as a general executive who in turn can employ subordinates who become agents of the corporation. In *Hoyt v. Thompson's Ex'r*,⁴² it was held that a board of 23 directors might delegate authority for the transaction of ordinary business to a quorum of five directors. A by-law declaring that the ordinary business of the corporation might be transacted by a quorum of

⁴⁰ *Hoyt v. Thompson's Ex'r*, 19 N. Y. 207; *Burden v. Burden*, 8 N. Y. App. Div. 160, 40 N. Y. Supp. 499, aff'd 159 N. Y. 287, 54 N. E. 17; *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163, 35 Am. Dec. 395; *McNeil v. Boston Chamber of Commerce*, 154 Mass. 277, 28 N. E. 245, 13 L. R. A. 559; *Jones v. Williams*, 139 Mo. 1, 39 S. W. 486, 37 L. R. A. 682, 61 Am. St. Rep. 436. See *Dyer Bros. Golden West Iron Works v. Central Iron Works*, 182 Cal. 588, 189 Pac. 445.

⁴¹ In *re Lone Star Shipbuilding Co.*, 6 Fed. (2d) 192, noted in 11 Cornell Law Quarterly 82; *Hoyt v.*

Thompson's Ex'r, 19 N. Y. 207. In *Beveridge v. New York El. R. Co.*, 112 N. Y. 1, 19 N. E. 489, 2 L. R. A. 648, it is said: "The powers of a board of directors are, in a very important sense, original and undelegated. The stockholders do not confer, nor can they revoke, these powers. They are like private principals." But see note, Power of directors to appoint executive committee, 20 Harvard Law Rev. 225.

⁴² 19 N. Y. 207. See note, 20 Harvard Law Rev. 225 (power of directors to appoint executive committee). *Haldeman v. Haldeman*, 176 Ky. 635, 197 S. W. 376.

five directors, the whole number being 23, was a valid regulation. If the board could constitute an executive committee of five or more named individuals, it could impart the same authority to a shifting quorum composed of the same number.

There is some question, however, whether the directors may delegate the duties of deciding the policy of the corporation, exercising discretion in important matters, and generally overseeing corporate affairs. In *Temple v. Dodge*,⁴³ it was held that a corporation whose charter vests the management of its affairs in a board of directors, cannot by a by-law, substitute an executive committee for such board, and a contract authorized by such committee was held not binding on the corporation. It was said that directors cannot confer upon others power to discharge duties which involve the exercise of judgment and discretion, except in the transaction of the ordinary business of the corporation, unless authorized so to do by the charter. But as a matter of business practice there is no doubt that in many companies the existence of the executive committee has reduced the directors to little more than a ratifying body. The full board of directors of many a company meet only at rare intervals to glance casually over the transactions of an executive committee of three or five members and approve them in a perfunctory manner. There is some limit, however, to the power of the directors or trustees to delegate authority and responsibility. As their authority to delegate is implied from the necessities in the management of the corporation, and from usage, so, also, it is limited by the same considerations. They cannot delegate entire supervision and control of the corporation to others, unless expressly authorized, for this is not only unnecessary and contrary to usage, but it is inconsistent with the charter or law, which requires that they shall have general supervision and control of the corporation.⁴⁴

They may doubtless delegate to subordinate officers or agents the exercise of comprehensive discretionary powers such as the making of contracts, and may authorize the general manager or other executive officer to represent the corporation in certain classes of transactions as well as in some particular contract or transaction.⁴⁵

⁴³ 89 Tex. 69, 32 S. W. 514, 33 S. W. 222. The by-law provided that "to said committee shall be and is hereby confided, all the powers of the board of directors." See *Hayes v. Canada, Atlantic & Plant S. S. Co., Ltd.*, 181 Fed. 289.

⁴⁴ *Ames v. Goldfield Merger Mines*

Co., 227 Fed. 292; *Davis v. Flagstaff Silver Min. Co.*, 2 Utah 74; *Temple v. Dodge*, 89 Tex. 69, 32 S. W. 514, 33 S. W. 222. Compare *Haldeman v. Haldeman*, 176 Ky. 635, 197 S. W. 376.

⁴⁵ *Dyer Bros. Golden West Iron Works v. Central Iron Works*, 182

It would be prudent, however, for one dealing with a corporation in any important transaction to insist on getting a certificate from the secretary under the seal of the corporation that at a meeting of the directors duly called and held at such and such a date, a quorum being present, a vote or resolution was passed authorizing certain officers or agents to act in the matter on behalf of the corporation.

Whether or not subordinate officers and agents of a corporation can delegate powers to other agents depends upon whether authority to do so has been expressly conferred, or can be implied. The president of a corporation, or any other officer or agent who has been intrusted by the charter, or by the stockholders or directors, with general authority to manage the business of the corporation, undoubtedly has the implied power to appoint usual and necessary subordinate agents to act under his supervision and control, although their acts may involve the exercise of judgment and discretion.⁴⁶ An officer or agent, however, has no authority to delegate special powers conferred upon him, and which involve the exercise of judgment or discretion, unless he is expressly authorized to do so, or unless the circumstances are such that the authority is necessarily implied.⁴⁷ Thus, it has been held that a general agent of a corporation, who has been given special authority by the stockholders or board of directors to execute negotiable instruments on behalf of the corporation, cannot, unless authorized to do so, delegate such power to a subordinate agent.⁴⁸

§ 102. Directors' meetings.

The by-laws of corporations usually provide for regular meetings of the directors or trustees, and fix the time therefor, and the stated meetings must be held at the time fixed.⁴⁹ The fact that regular

Cal. 588, 189 Pac. 445; *Salem Iron Co. v. Lake Superior Consol. Iron Mines*, 112 Fed. 239; *Jones v. Williams*, 139 Mo. 1, 39 S. W. 486, 40 S. W. 353, 37 L. R. A. 682, 61 Am. St. Rep. 436; *Bradley v. Nevada-California-Oregon Ry.*, 42 Nev. 411, 178 Pac. 906; *Pink v. Metropolitan Milk Co.*, 129 Minn. 353, 152 N. W. 725 (a corporation may hire a cashier and accountant without resolution or other direct act of the board of directors. Such power is presumably incident to the position of general manager of a corporation).

⁴⁶ *Emerson v. Providence Hat Mfg. Co.*, 12 Mass. 237, 7 Am. Dec.

66; *Luttrell v. Martin*, 112 N. C. 593, 17 S. E. 573; *Jones v. Williams*, 139 Mo. 1, 39 S. W. 486, 40 S. W. 353, 37 L. R. A. 682, 61 Am. St. Rep. 436.

⁴⁷ *Emerson v. Providence Hat Mfg. Co.*, 12 Mass. 237, 7 Am. Dec. 66; *Caldwell v. Mutual Reserve Fund Life Ass'n*, 53 N. Y. App. Div. 245, 65 N. Y. Supp. 826; *Middletown & H. Turnpike Road v. Watson*, 1 Rawle (Pa.) 330.

⁴⁸ *Emerson v. Providence Hat Mfg. Co.*, 12 Mass. 237, 7 Am. Dec. 66.

⁴⁹ See *Atlantic Mut. Fire Ins. Co. v. Sanders*, 36 N. H. 252.

meetings are thus required does not prevent the directors or trustees from holding special meetings, whenever the business of the company renders it necessary or expedient for them to do so.⁵⁰

Place of meeting.—In the absence of provision to the contrary, the directors or trustees may hold meetings at any reasonably convenient place within the state;⁵¹ but if the charter or by-laws require that meetings shall be held at the domicile or principal office of the corporation, or other specified place, the provision must be complied with.⁵² The fact that the place of holding regular or stated meetings is thus fixed, however, does not prevent special meetings from being held elsewhere.⁵³

There can be no question as to the validity of directors' or trustees' meetings held outside of the state, where the charter or statute expressly authorizes it, as is sometimes the case.⁵⁴ On the other hand, the charter, statute or by-laws may expressly require meetings to be held within the state, and in such a case the directors cannot bind the corporation at a meeting held in another state.⁵⁵

Whether the directors or trustees can lawfully meet and act outside of the state, in the absence of any provision on the subject, depends, according to some decisions, upon the nature of the business transacted. Such fundamental, internal matters as the making of calls for unpaid subscriptions or the election of officers of

⁵⁰ *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187. See *Cheney v. Canfield*, 158 Cal. 342, 111 Pac. 92, 32 L. R. A. (N. S.) 16. If the day for a regular meeting falls on a holiday, the board may meet on that day, or meet and adjourn to another day.

⁵¹ *Corbett v. Woodward*, 5 Sawy. 403, Fed. Cas. No. 3223.

⁵² See *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187.

⁵³ *Corbett v. Woodward*, 5 Sawy. 403, Fed. Cas. No. 3223; *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187.

⁵⁴ *Humphreys v. Mooney*, 5 Colo. 282; *Brockway v. Gadsden Mineral Land Co.*, 102 Ala. 620, 15 So. 431; *Bassett v. Monte Christo Gold & Silver Min. Co.*, 15 Nev. 293; *Lippman v. Kehoe Stenograph Co.*, 11 Del. 190, 98 Atl. 943; s. c., 11 Del. 412, 102 Atl. 988.

Twenty states have statutes expressly authorizing directors' meetings to be held outside the state as follows: Alabama, Illinois, Maine, Maryland, Massachusetts, Minnesota, Montana, Nevada, New Hampshire, New Mexico, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington and West Virginia.

Eight states have statutes authorizing them, if provided in by-laws or articles of incorporation: Colorado, Delaware, Idaho, Michigan, Oklahoma, Porto Rico, South Dakota and Utah. But California and Missouri require directors' meetings within the state.

⁵⁵ *Hilles v. Parrish*, 14 N. J. Eq. 380; *Webb & Co. v. Midway Lumber Co.*, 68 Mo. App. 546; *State Nat. Bank of St. Joseph v. Union Nat. Bank of Chicago*, 168 Ill. 519, 48 N. E. 82.

the corporation may not be dealt with outside the state under this doctrine, while ordinary contracts and conveyances can.⁵⁶ In accordance with this doctrine, it has been held that the directors cannot meet outside of the state and make assessments or calls on unpaid subscriptions,⁵⁷ or elect or appoint officers of the corporation.⁵⁸ When a directors' meeting is illegally or improperly held outside of the state, no person who participates therein or acquiesces can object;⁵⁹ and the stockholders and corporation may be estopped as against innocent third persons.⁶⁰

Notice of meeting.—If the meeting is a regular or stated one, the time and place being fixed by the charter or by-laws, or by usage, notice of the meeting is not necessary, unless expressly required.⁶¹ Nor is it necessary to give notice of an adjourned annual or stated meeting.⁶²

Special meetings—Notice.—When a number of directors are elected to manage the affairs of the corporation, it is contemplated that the corporation shall have the benefit of the judgment, counsel, and influence of all, and it is only right to hold that, in the absence of special circumstances or express provision to the contrary, every one of them should have an opportunity to be present at meetings of the board. The great weight of authority, therefore, is to the effect that notice of a special meeting must be given to every director, unless there is some express provision in the charter or by-laws or established usage to the contrary, or unless it is impossible or impracticable to do so. Except in these cases, a special

⁵⁶ Reichwald v. Commercial Hotel Co., 106 Ill. 439; Saltmarsh v. Spaulding, 147 Mass. 224, 17 N. E. 316; Galveston R. Co. v. Cowdrey, 11 Wall. (U. S.) 459, 20 L. Ed. 199; Wright v. Bundy, 11 Ind. 398. But see State Nat. Bank of St. Joseph v. Union Nat. Bank of Chicago, 168 Ill. 519, 48 N. E. 82; Fletcher, Corporations, sec. 1865. See 2 Mechen, Corporations, sec. 1462: "This distinction is however very shadowy and it is submitted, unsound."

⁵⁷ Union Nat. Bank v. State Nat. Bank, 155 Mo. 95, 55 S. W. 989, 78 Am. St. Rep. 560; Aspinwall v. Ohio & M. R. Co., 20 Ind. 492, 83 Am. Dec. 329; Reichwald v. Commercial Hotel Co., 106 Ill. 439.

⁵⁸ Place v. People, 87 Ill. App. 527. Contra, McCall v. Byram Mfg. Co., 6 Conn. 428.

⁵⁹ Wood v. Boney (N. J. Ch.) 21 Atl. 574; In re Wilson's Estate, 85 Ore. 604, 167 Pac. 580.

⁶⁰ Galveston R. Co. v. Cowdrey, 11 Wall. (U. S.) 459, 20 L. Ed. 199.

⁶¹ Seal of Gold Min. Co. v. Slater, 161 Cal. 621, 120 Pac. 15; Atlantic Mut. Fire Ins. Co. v. Sanders, 36 N. H. 252; Whitehead v. Hamilton Rubber Co., 52 N. J. Eq. 78, 27 Atl. 897; Western Improvement Co. v. Des Moines Nat. Bank, 103 Iowa 455, 72 N. W. 657.

⁶² Western Improvement Co. v. Des Moines Nat. Bank, 103 Iowa 455, 72 N. W. 657; Whitcomb v. Giannini, 43 Cal. App. 229, 184 Pac. 887. Contra, under the California statute as to regular meetings, Thompson v. Williams, 76 Cal. 153, 18 Pac. 153, 9 Am. St. Rep. 187.

meeting held in the absence of some of the directors, and without any notice to them, is illegal, and the action at such a meeting, although by a majority of the directors, is invalid,⁶³ unless subsequently ratified, or unless rights have been acquired by innocent third persons, as against whom the corporation must be held estopped. Notice is necessary in all cases, of course, when required by the charter or by-laws, unless all the directors are present.⁶⁴

Unless there is some express provision to the contrary, a general notice of a directors' meeting, not specifying the business to be transacted, is all that is necessary to authorize the transaction of the ordinary business affairs of the corporation.⁶⁵ It has been held that extraordinary business may be transacted, although not specified in the notice,⁶⁶ but this is doubtful.⁶⁷ If a notice expressly states that the meeting is called for a particular purpose, or for ordinary business, extraordinary business outside of such purpose cannot be transacted unless all the directors are present.⁶⁸ The notice of a directors' meeting must be a personal notice,⁶⁹ unless, as may be the case, notice by mail or otherwise is authorized by the by-laws or by custom,⁷⁰ or unless, by reason of absence, notice can-

⁶³ *Thompson v. Williams*, 76 Cal. 153, 18 Pac. 153, 9 Am. St. Rep. 187; *Pauly v. Pauly*, 107 Cal. 8, 40 Pac. 29, 48 Am. St. Rep. 98; *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Sargent & Co. v. Heggen*, 195 Iowa 361, 190 N. W. 506; *Broughton v. Jones*, 120 Mich. 462, 79 N. W. 691; *Whitehead v. Hamilton Rubber Co.*, 52 N. J. Eq. 78, 27 Atl. 897; *Whittaker v. Amwell Nat. Bank*, 52 N. J. Eq. 400, 29 Atl. 203; *In re Argus Co.*, 138 N. Y. 557, 34 N. E. 388.

⁶⁴ *Thompson v. Williams*, 76 Cal. 153, 18 Pac. 153, 9 Am. St. Rep. 187; *Hill v. Rich Hill Coal Min. Co.*, 119 Mo. 9, 24 S. W. 223; *Waterman v. Chicago & I. R. Co.*, 139 Ill. 658, 29 N. E. 689, 15 L. R. A. 418, 32 Am. St. Rep. 228; *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132.

⁶⁵ *In re Argus Co.*, 138 N. Y. 557, 34 N. E. 388. And see *Compagnie de Mayville v. Whitney* [1896] 1 Ch. 788; *New Haven Sav. Bank v. Davis*, 8 Conn. 192.

⁶⁶ *Compagnie de Mayville v. Whitney*, [1896] 1 Ch. 788.

⁶⁷ *Mercantile Library Hall Co. v. Pittsburg Library Ass'n*, 173 Pa. St. 30, 33 Atl. 744.

⁶⁸ *Mercantile Library Hall Co. v. Pittsburg Library Ass'n*, 173 Pa. St. 30, 33 Atl. 744.

⁶⁹ *Harding v. Vandewater*, 40 Cal. 77; *Bank of Little Rock v. McCarthy*, 55 Ark. 473, 18 S. W. 759, 29 Am. St. Rep. 60.

⁷⁰ *Williams v. German Mut. Fire Ins. Co. of North Chicago*, 68 Ill. 387; *Stockton Combined Harvester & Agricultural Works v. Houser*, 109 Cal. 1, 41 Pac. 809.

Notice by mail is sufficient if it is shown to have been received. *People ex rel. Swinburne v. Albany Medical College*, 26 Hun (N. Y.) 348, aff'd 89 N. Y. 635; *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187.

And it has been held that, when notice is sent by mail, its receipt will be presumed, in the absence of proof to the contrary. *Stockton Combined Harvester & Agricultural Works v. Houser*, 109 Cal. 1, 41 Pac. 809.

not be given except by mail or telegraph.⁷¹ And the notice must be given a reasonable length of time before the hour or day fixed for the meeting.⁷²

A directors' meeting is not illegal, or the action thereat invalid, because of failure to give notice to a person who has been elected a director, but has not accepted,⁷³ or to a director who would have been disqualified from taking part by reason of personal interest.⁷⁴ Failure to give notice to directors may be excused because of their absence and inaccessibility, and the necessity for immediate or prompt action.⁷⁵ Thus in a Kansas case,⁷⁶ three of the directors were outside the state and no notice was given them. It was held that since they were beyond the reach of any notice that would be beneficial, to have given them notice would have been going through a form without accomplishing anything. Since there was not time properly to serve notices upon the absent directors, a majority who were present and acted in good faith for the interest of the corporation could bind it. The validity of a meeting is not affected by failure to give notice, even when notice was expressly required by the charter or by-laws, if all the directors were present and raised no objection.^{76a} And failure to give notice of a directors' meeting cannot be set up to defeat the rights of innocent third persons dealing with the corporation, for they have a right to assume that the meeting was regular.⁷⁷ Acts of directors at a meeting which was illegal because of want of notice may be ratified by the directors at a subsequent legal meeting,⁷⁸ or it may be ratified by the stock-

⁷¹ Chase v. Tuttle, 55 Conn. 455, 12 Atl. 874, 3 Am. St. Rep. 64.

⁷² Hayes v. Canada, Atlantic & Plant S. S. Co., Ltd., 181 Fed. 289; Mercantile Library Hall Co. v. Pittsburg Library Ass'n, 173 Pa. St. 30, 33 Atl. 744; In re Homer District Consol. Gold Mines, 39 Ch. Div. 546. Compare In re Argus Co., 138 N. Y. 557, 34 N. E. 388.

⁷³ Whittaker v. Amwell Nat. Bank, 52 N. J. Eq. 400, 29 Atl. 203.

⁷⁴ Troy Min. Co. v. White, 10 S. D. 475, 74 N. W. 236, 42 L. R. A. 549; Ney v. Eastern Iowa Tel. Co., 185 Iowa 610, 171 N. W. 26.

⁷⁵ Halifax Sugar Refining Co. v. Francklyn, 62 Law T. (N. S.) 563; Chase v. Tuttle, 55 Conn. 455, 12 Atl. 874, 3 Am. St. Rep. 64; National Bank of Commerce v. Shumway, 49 Kan. 224, 30 Pac. 411. And see Bank of Little Rock v. McCarthy,

55 Ark. 473, 18 S. W. 759, 29 Am. St. Rep. 60; Porter v. Robinson, 30 Hun (N. Y.) 209; Defanti v. Allen-Clark Co., 45 Nev. 120, 193 Pac. 549 (semble).

⁷⁶ National Bank of Commerce v. Shumway, 49 Kan. 224, 30 Pac. 411.

^{76a} Minneapolis Times Co. v. Nimocks, 53 Minn. 381, 55 N. W. 546; Robson v. C. E. Fenniman Co., 83 N. J. Law 453, 85 Atl. 356.

⁷⁷ Kuser v. Wright, 52 N. J. Eq. 825, 31 Atl. 397; Ashley Wire Co. v. Illinois Steel Co., 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187; Berman v. Minneapolis Photo Engraving Co., 144 Min. 146, 174 N. W. 735. But compare Wright v. First Nat. Bank, 52 N. J. Eq. 392, 28 Atl. 719.

⁷⁸ In re Portuguese Consol. Copper Mines, 45 Ch. Div. 16; Taylor County Court v. Baltimore & O. R. Co.,

holders, expressly or by acquiescence,⁷⁹ if they could have authorized the act, but not otherwise.⁸⁰ It will be presumed that proper notice of a meeting was given to all the directors, in the absence of proof to the contrary, particularly when the records or minutes of the corporation recite that notice was given.⁸¹

Quorum.—In the case of stockholders' meetings,⁸² any number, provided there are at least two, constitutes a quorum for the transaction of business, unless there is some provision to the contrary; but this rule does not apply to select bodies, like a board of directors or trustees. In the absence of provision to the contrary in the charter or by-laws, a majority of the directors or trustees is necessary, and is sufficient, to constitute a quorum, and to transact business.⁸³ Less than a majority cannot meet and bind the corporation by any act or resolution, unless expressly authorized. All they can do is to adjourn. Action at a meeting of directors which was illegal because of the absence of a quorum may be afterwards ratified at a legal meeting,⁸⁴ or by the stockholders, if they could have authorized the action in the first instance,⁸⁵ but not otherwise.⁸⁶

35 Fed. 161; *Smith v. New Hartford Water Co.*, 73 Conn. 626, 48 Atl. 754.

Ratification by the directors individually is not effective, according to some decisions, but only when made by the board. *Milligan v. G. D. Milligan Grocer Co.*, 207 Mo. App. 472, 233 S. W. 506.

So a waiver of notice by an absent director subsequent to a meeting is ineffective. *Lippman v. Kehoe Co.*, 11 Del. Ch. 80, 95 Atl. 895. *Cp. Stafford Springs St. R. Co. v. Middle River Mfg. Co.*, 80 Conn. 37, 66 Atl. 775.

⁷⁹ *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187. And see *Johnson Co. v. Miller*, 174 Pa. St. 605, 34 Atl. 316, 52 Am. St. Rep. 833.

⁸⁰ *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132.

⁸¹ *Sargent v. Webster*, 13 Mete. (Mass.) 497, 46 Am. Dec. 743; *Chase v. Tuttle*, 55 Conn. 455, 12 Atl. 874, 3 Am. St. Rep. 64; *Chouteau Ins. Co. v. Holmes' Adm'r*, 68 Mo. 601, 30 Am. St. Rep. 807; *Singer v. Salt Lake City Copper Mfg. Co.*, 17 Utah 143, 53 Pac. 1024, 70 Am. St. Rep.

773; *Balfour-Guthrie Inv. Co. v. Woodworth*, 124 Cal. 169, 56 Pac. 891; *Barrell v. Lake View Land Co.*, 122 Cal. 129, 54 Pac. 594.

⁸² *Fletcher, Corporations*, sec. 1643.

⁸³ *Ernest v. Nicholls*, 6 H. L. Cas. 401; *Sargent v. Webster*, 13 Mete. (Mass.) 497, 46 Am. Dec. 743; *Chase v. Tuttle*, 55 Conn. 455, 12 Atl. 874, 3 Am. St. Rep. 64; *Ten Eyck v. Pontiac, O. & P. A. R. Co.*, 74 Mich. 226, 41 N. W. 905, 3 L. R. A. 378, 16 Am. St. Rep. 633; *Smith v. Los Angeles Immigration & Land Co-operative Ass'n*, 78 Cal. 289, 20 Pac. 677, 12 Am. St. Rep. 53; *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Calumet Paper Co. v. Haskell Show Printing Co.*, 144 Mo. 331, 45 S. W. 1115, 66 Am. St. Rep. 425.

⁸⁴ *In re Portuguese Consol. Copper Mines*, 45 Ch. Div. 16.

⁸⁵ *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187.

⁸⁶ *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132.

Number necessary to decide.—When there is a quorum of directors at a meeting of which proper notice has been given, a majority of the quorum has the power to decide any question coming before the meeting, although they may be less than a majority of the board, unless there is some express provision in the charter or by-laws to the contrary.⁸⁷

Disqualification by personal interest.—A director who is disqualified by reason of personal interest in the matter before a directors' meeting loses, *pro hac vice*, his character as a director, and he cannot be counted for the purpose of making out a quorum.⁸⁸ Nor can the vote of a director who is so disqualified be counted for the purpose of determining whether a resolution has been passed by a majority vote.⁸⁹ But the validity of a resolution or other action is not affected by the fact that a disqualified director was present or voted, if there was a quorum without him, and the necessary majority vote in favor of the resolution or act without counting his vote.⁹⁰ His vote, in other words, is a mere nullity.

⁸⁷ *Ex parte Willcocks*, 7 Cow. (N. Y.) 402, 17 Am. Dec. 525; *Sargent v. Webster*, 13 Mete. (Mass.) 497, 46 Am. Dec. 743; *Despatch Line of Packets v. Bellamy Mfg. Co.*, 12 N. H. 205, 37 Am. Dec. 203; *Leavitt v. Oxford & Geneva Silver Min. Co.*, 3 Utah 265, 1 Pac. 356; *Ten Eyck v. Pontiac, O. & P. A. R. Co.*, 74 Mich. 226, 41 N. W. 905, 3 L. R. A. 378, 16 Am. St. Rep. 633. See *Sargent & Co. v. Heggen*, 195 Iowa 361, 190 N. W. 506.

⁸⁸ *In re Lone Star Shipbuilding Co.*, 6 Fed. (2d) 192 (a director who has an adverse interest is not qualified to even constitute a member of a quorum); *Metropolitan Telephone & Telegraph Co. v. Domestic Telegraph & Telephone Co.*, 43 N. J. Eq. 626, 14 Atl. 908, 44 N. J. Eq. 568, 14 Atl. 907; *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Hotaling v. Hotaling*, 193 Cal. 368, 224 Pac. 455; *Hill v. Rich Hill Coal Min. Co.*, 119 Mo. 9, 24 S. W. 223; *Fields v. Victor Building & Loan Co.*, 73 Okla. 207, 175 Pac. 529.

In New Blue Point Min. Co. v. Weissbein, — Cal. —, 244 Pac. 325, 329, it is said: "It may also be noted in passing that the California

cases, which hold that a director cannot legally form part of a quorum which acts upon a proposition in which he is personally interested, hold that the corporate act in which said director has participated is 'voidable.' They do not use the term 'void,' and it would seem, therefore, that some affirmative act of disaffirmance is necessary on the part of the corporation to take advantage of the irregularity."

⁸⁹ *Butts v. Wood*, 37 N. Y. 317; *Copeland v. Johnson Mfg. Co.*, 47 Hun (N. Y.) 235; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Smith v. Los Angeles Immigration & Land Co-operative Ass'n*, 78 Cal. 289, 20 Pac. 677, 12 Am. St. Rep. 53; *Doyle v. Mizner*, 42 Mich. 332, 3 N. W. 968; *Hill v. Rich Hill Coal Mining Co.*, 119 Mo. 9, 24 S. W. 223; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854.

⁹⁰ *Clark v. American Coal Co.*, 86 Iowa 436, 53 N. W. 291, 17 L. R. A. 557; *Keans v. New York & College Point Ferry Co.*, 17 N. Y. Misc. 272, 40 N. Y. Supp. 366; *Ten Eyck v. Pontiac, Oxford & P. A. R. Co.*, 74 Mich. 226, 41 N. W. 905, 3 L. R. A. 378, 16 Am. St. Rep. 633; *In re Franklin Brewing Co.*, 263 Fed. 512. Post, §§ 122-124.

Voting by proxy.—The directors of a corporation cannot vote at directors' meetings by proxy, but must be personally present, and act themselves.⁹¹

Presumption.—In the absence of evidence to the contrary, when any action purports to have been the action of the directors at a meeting of the board, it will be presumed that a quorum was present, that the meeting was properly conducted, and that the action in question was the action of the majority.⁹²

II. OTHER OFFICERS AND AGENTS.

§ 103. Authority of officers and agents in general.

The president, treasurer, secretary, manager, cashier, and other officers of a corporation are merely its agents, appointed by the board of directors, and vested with such powers, and such powers only, as may be conferred upon them by the corporation, subject, of course, to any express charter or statutory provisions. Their power to bind the corporation is determined by the extent of the authority expressly or impliedly conferred upon them by resolution of the directors, by the by-laws of the corporation, or otherwise, and by application of the general principles governing the relation of principal and agent. The general rule is that contracts or acts in excess of their authority will not bind the corporation, in the absence of estoppel or ratification. When there is no question as to the clothing of an officer or agent with apparent authority, all persons dealing with him are bound to ascertain his authority, and, if they deal with him without inquiry, they act at their peril, and cannot hold the corporation liable if the officer or agent was without authority in fact, unless they can establish an estoppel against the corporation, or show a ratification.^{92a}

§ 104. Individual directors not agents.

The directors or trustees of a corporation are not individually the agents of the corporation, and have no power individually to bind it by any contract or other transaction. The fact that a person assuming to act for a corporation is a director does not even raise a presumption that he is its authorized agent.⁹³ A director,

⁹¹ *Craig Medicine Co. v. Merchants' Bank of Rochester*, 59 Hun (N. Y.) 561, 14 N. Y. Supp. 16; *Perry v. Tuskaloosa Cotton-Seed Oil-Mill Co.*, 93 Ala. 364, 9 So. 217.

⁹² *Despatch Line of Packets v. Bellamy Mfg. Co.*, 12 N. H. 205, 37 Am. Dec. 203; *Rollins v. Shaver Waggon & Carriage Co.*, 80 Iowa 380, 45

N. W. 1037, 20 Am. St. Rep. 427; *Fletcher v. Chicago, St. P., M. & O. Ry. Co.*, 67 Minn. 339, 69 N. W. 1085.

^{92a} *Aerial League of America v. Aircraft Fireproofing Corp.*, 97 N. J. Law 530, 117 Atl. 704.

⁹³ *Trott v. Warren*, 11 Me. 227; *Pierce v. Morse-Oliver Building Co.*,

of course, may be expressly authorized to act for the corporation as its agent in a particular matter, or he may be intrusted with the general management of the corporation, or he may be clothed with apparent authority by being permitted to act.⁹⁴

§ 105. The president's authority.

The president of a corporation may be given the power to make particular contracts, or to execute conveyances, borrow money, execute mortgages, and do other acts, by the charter of the corporation, the by-laws, or by the board of directors. He may be given general authority to supervise and manage the business of the corporation, or a particular part of it. In such a case, his authority extends impliedly to any contract or other act which is incident to the ordinary business of the corporation, or to that part with which he is intrusted, without special authority to make the particular contract or do the particular act.⁹⁵ Furthermore, a corporation may be estopped to deny the authority of its president by clothing him with apparent authority to act for it in making contracts or doing other acts, as where it allows him habitually to make such contracts or do such acts, or to manage the business generally, although no authority may have been expressly conferred upon him.⁹⁶

Powers incident to office.—In view of the fact that presidents of corporations are often given general supervision and control over their management, it has been held by some courts that con-

94 Me. 406; Morrison v. Wilder Gas Co., 91 Me. 492, 40 Atl. 542, 64 Am. St. Rep. 257; Lyndon Mill Co. v. Lyndon Literary & Biblical Institution, 63 Vt. 581, 22 Atl. 575, 25 Am. St. Rep. 783; Henry Wood's Sons Co. v. Schaefer, 173 Mass. 443, 53 N. E. 881, 73 Am. St. Rep. 305; Allemong v. Simmons, 124 Ind. 199, 23 N. E. 768; Buttrick v. Nashua & Lowell R. Co., 62 N. H. 413, 13 Am. St. Rep. 578; First Nat. Bank v. Drake, 35 Kan. 564, 11 Pac. 445, 57 Am. Rep. 193; Chicago & N. W. Ry. Co. v. James, 22 Wis. 194.

94 Robinson Reduction Co. v. Johnson, 10 Colo. App. 135, 50 Pac. 215. See Kissel v. Murray, 197 Iowa 17, 196 N. W. 591, 33 A. L. R. 1346. If a director signs a note of which the corporation is maker as director he incurs personal liability, because if his signature did not impose such liability, it meant nothing.

95 Crowley v. Genesee Min. Co., 55 Cal. 273; Rathbun v. Snow, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 355; Leroy & C. V. Air-Line R. Co. v. Sidell, 66 Fed. 27; Missouri Pacific Ry. Co. v. Sidell, 67 Fed. 464; Fleitmann v. John M. Stone Cotton Mills, 186 Fed. 466; Ko Eun Co. v. Manayunk Yarn Mfg. Co., 260 Pa. 340, 103 Atl. 720, 5 A. L. R. 1483, 1485n. Power of president of a corporation to employ or discharge agents or subordinates.

96 Chambers v. Lancaster, 160 N. Y. 342, 54 N. E. 707; Oakes v. Cataraugus Water Co., 143 N. Y. 430, 38 N. E. 461, 26 L. R. A. 544; Leroy & C. V. Air-Line R. Co. v. Sidell, 66 Fed. 27; Missouri Pac. Ry. Co. v. Sidell, 67 Fed. 464. See Grant v. Duluth, M. & N. Ry. Co., 66 Minn. 349, 352, 69 N. W. 23. And see, post, § 110.

tracts or acts made or done by the president of a corporation in the course of its ordinary business will be presumed to have been within his authority, unless the contrary appears.⁹⁷ The prevailing doctrine, however, is to the contrary. According to the weight of authority, whether he has authority to do a particular act depends upon the powers conferred upon him, either by the charter, or by the by-laws or by the directors. He may be expressly authorized to do a particular act, or he may be expressly given the general management of the corporation, or he may be clothed with apparent authority, so that his acts will be binding on the corporation; or he may be a mere figurehead, with no other duties than to preside at the meetings of directors; or his authority may range anywhere between these extremes. The mere fact that he is president, without more, does not imply that he has any greater power than any other director.⁹⁸

Suppose a promissory note of a religious corporation is offered in evidence. The note purports on its face to be the obligation of the defendant corporation and is signed by persons who purport to be officers of the defendant, president, secretary and treasurer. What must be shown in order to prove the authority of the officers to execute the note and bind the corporation? In *People's Bank of City of New York v. St. Anthony's R. C. Church*,⁹⁹ it was said that

⁹⁷ *Ransome Concrete Machinery Co. v. Moody*, 282 Fed. 29; *Smith v. Smith*, 62 Ill. 493; *Mullanphy Sav. Bank v. Schott*, 135 Ill. 655, 26 N. E. 640, 25 Am. St. Rep. 401; *Weber v. Aluminum Ore Co.*, 304 Ill. 273, 136 N. E. 685; *Powers v. Schlicht Heat, Light & Power Co.*, 23 N. Y. App. Div. 380, 48 N. Y. Supp. 237, aff'd 165 N. Y. 662, 59 N. E. 1129; *Gluck v. Bedford Cleaning & Dyeing Co.*, 195 N. Y. App. Div. 493, 186 N. Y. Supp. 823; *Spitzer v. Born, Inc.*, 194 N. Y. App. Div. 739, 185 N. Y. Supp. 875; *Patterson v. Robinson*, 116 N. Y. 193, 22 N. E. 372; *White v. Elgin Creamery Co.*, 108 Iowa 522, 79 N. W. 283.

⁹⁸ *Titus v. Cairo & F. R. Co.*, 37 N. J. Law 98; *Stokes v. New Jersey Pottery Co.*, 46 N. J. Law 237; *Lyndon Mill Co. v. Lyndon Literary & Biblical Institution*, 63 Vt. 581, 22 Atl. 535, 25 Am. St. Rep. 783; *City Electric Street Ry. Co. v. First Nat. Exch. Bank*, 62 Ark. 33, 34 S. W. 89, 31 L. R. A. 535, 54 Am. St. Rep. 282; *Blen v. Bear River & Auburn*

Water & Mining Co., 20 Cal. 602, 81 Am. Dec. 132; *Jan Wai v. Smith-Riddell Co.*, 55 Cal. App. 59, 202 Pac. 952; *Catholic Foreign Mission Soc. v. Oussani*, 215 N. Y. 1, 109 N. E. 80, Ann. Cas. 1917 A 479, 482n; *Cope-Swift Co. v. John Schlaff Creamery Co.*, 223 Mich. 543, 194 N. W. 550; *Wait v. Nashua Armory Ass'n*, 66 N. H. 581, 23 Atl. 77, 49 Am. St. Rep. 630; *Grant v. Duluth, M. & N. Ry. Co.*, 69 N. W. 23, 66 Minn. 349; *Rumbough v. Southern Imp. Co.*, 112 N. C. 751, 17 S. E. 536, 34 Am. St. Rep. 528; *Crown Paving & Const. Co. v. Walla Walla Co.*, 122 Wash. 144, 210 Pac. 357.

⁹⁹ 109 N. Y. 512, 523, 17 N. E. 408. It is not the common usage that the president, secretary and treasurer of a religious society have power, by virtue of their offices, to borrow money or issue notes of the corporation. They can only act in such a transaction by virtue of a special authority from the board of directors. See 12 A. L. R. 130n, implied or apparent authority of cor-

proof that a promissory note purporting to be made by a corporation was signed by its president and secretary, does not show that it is the note of the corporation, without proof that it was authorized by the directors. The president of a corporation, the National Radio Co., signed a contract for advertising space in the plaintiff's magazine for one year at \$200 per month. The president had not been authorized by resolution of the board of directors to sign the contract. The by-laws conferred on the president merely "the general powers and duties usually vested in the office of president of a corporation." The corporation had a general manager at the time, but the contract was not signed either by the secretary or manager, nor was it under the corporate seal. It was held that the president had no authority to bind the corporation.^{99a} Thus it has been frequently held that the president of a corporation, where he has not been intrusted with its management, has no implied or inherent authority to contract generally for it by virtue of his office alone.¹⁰⁰ But it seems that the doctrine is growing that in accordance with the business idea that the president is head of the corporation subject to control of the board of directors, that he has certain ostensible authority in conducting the routine business of the company merely as president.¹⁰¹

§ 106. The vice president.

The vice president of a corporation has no authority to bind it, merely by virtue of his office, by notes or other contracts, or to dispose of its property;¹⁰² but he is often intrusted with the management of the business, or a particular part of it, and in such a case he may bind the corporation by any contract within the scope or apparent scope of his authority.¹⁰³ As a general rule, in he

porate officers to indorse commercial paper.

^{99a} *International Magazine Co. v. National Radio Co.*, 67 Cal. App. 498, 227 Pac. 918.

¹⁰⁰ *Stanley v. Sheffield Land, Iron & Coal Co.*, 83 Ala. 260, 4 So. 34; *Templin v. Chicago, B. & P. Ry. Co.*, 73 Iowa 548, 35 N. W. 634; *Wait v. Nashua Armory Ass'n*, 66 N. H. 581, 23 Atl. 77, 14 L. R. A. 356, 49 Am. St. Rep. 630; *Central Trust Co. of New York v. Condon*, 67 Fed. 84; *National State Bank of Terre Haute v. Vigo County Nat. Bank*, 141 Ind. 352, 40 N. E. 799, 50 Am. St. Rep. 330; *Grant v. Duluth, M. & N. Ry. Co.*, 66 Minn. 349, 69

N. W. 23; *Colton v. Depew*, 59 N. J. Eq. 126, 44 Atl. 662.

¹⁰¹ *Dickinson v. Citizen's Ice & Fuel Co.*, 139 Minn. 201, 165 N. W. 1056.

¹⁰² *Morris v. Griffith & Wedge Co.*, 69 Fed. 181; *American Loan & Trust Co. v. St. Louis & Chicago Ry. Co.*, 42 Fed. 819. But see *Peyton v. Sturgis* (Tex. Civ. App.) 202 S. W. 205; *Milwaukee Trust Co. v. Van Valkenburgh*, 132 Wis. 638, 112 N. W. 1083 (presumption of powers).

¹⁰³ *Streeten v. Robinson*, 102 Cal. 542, 36 Pac. 946; *Lacaze v. Creditors*, 46 La. Ann. 237; *Huse v. Ames*, 104 Mo. 91, 15 S. W. 965; *Cox v. Robinson*, 82 Fed. 277; *Rum-*

absence of the president, or if the office of president becomes vacant, the vice president, if one has been elected or appointed by the stockholders or directors, has authority to act in his stead, and to perform any duties of the office.¹⁰⁴

§ 107. The secretary.

It is generally the duty of the secretary of a corporation to make and keep its records, and to make proper entries of the votes, resolutions, and proceedings of the stockholders and directors in the management of the corporation, and of all other matters required to be entered on the records. And he also may be expressly authorized by the charter of the corporation, or by the stockholders or directors, to act for it in managing the business so as to have implied authority to make contracts and do other acts.¹⁰⁵ Unless authority is expressly conferred, however, or he is clothed with apparent authority by being intrusted with the management of the business, or a part of it, the secretary of a corporation has no authority to make any contracts on its behalf and in its name, or bind it by other acts. He has no such authority merely by virtue of his office.¹⁰⁶

§ 108. The treasurer.

The treasurer of a corporation is the proper officer, and the only proper officer, in the absence of express provision to the contrary, to receive and keep the moneys of the corporation, and to disburse them as he may be authorized. He has authority to receive and receipt for moneys due the corporation.¹⁰⁷ He may also be intrusted with the general management of its business, or a particular part of it; and in such a case, of course, he has the same author-

bough v. Southern Improvement Co., 106 N. C. 461, 11 S. E. 528; Bradford v. Little Cahaba Coal Co., 205 Ala. 372, 87 So. 571.

¹⁰⁴ Smith v. Smith, 62 Ill. 493; Colman v. West Virginia Oil & Oil Land Co., 25 W. Va. 148; Aaronson v. David Meyer Brewing Co., 26 N. Y. Misc. 655, 56 N. Y. Supp. 387.

¹⁰⁵ Kraniger v. People's Building Soc., 60 Minn. 94, 61 N. W. 904; Hastings v. Brooklyn Life Ins. Co., 138 N. Y. 473, 34 N. E. 289; Moore v. H. Gaus & Sons Mfg. Co., 113 Mo. 98, 20 S. W. 975. See Hoisting Machinery Co. v. Goeller Iron Works, 84 N. J. Law 504, 87 Atl. 331.

¹⁰⁶ Sears v. Illinois Wesleyan Uni-

versity, 28 Ill. 183; Fawcett v. New Haven Organ Co., 47 Conn. 224; Wolf v. Davenport, I. & D. R. Co., 93 Iowa 218, 61 N. W. 847; Read v. Buffum, 79 Cal. 77, 21 Pac. 554, 12 Am. St. Rep. 131; Thomasson v. Grace M. E. Church, 113 Cal. 558, 45 Pac. 838; Winsted Hosiery Co. v. New Britain Knitting Co., 69 Conn. 565, 38 Atl. 310; Citizens Development Co. v. Kypawva Oil Co., 191 Ky. 183, 229 S. W. 88; Aetna Casualty & Surety Co. v. American Brewing Co., 63 Mont. 474, 208 Pac. 921.

¹⁰⁷ Brown v. Winnisimmet Co., 11 Allen (Mass.) 326; People v. Carter, 122 Mich. 668, 81 N. W. 924.

ity, in the absence of restrictions, as any other manager.¹⁰⁸ As a general rule, however, the treasurer of a corporation has no implied authority, merely by virtue of his office, to bind the corporation by contracts or other acts made or done in its name, or to dispose of its assets except as he may be authorized by the directors or other managing officers.¹⁰⁹ Ordinarily, therefore, he has no implied authority to borrow money in the name of the corporation;¹¹⁰ to execute notes, draw or accept bills, drafts, or orders, or indorse notes or bills.¹¹¹

§ 109. General manager.

When an officer or agent of a corporation is intrusted by the stockholders or directors with the general management of the business of the corporation, the general rule is that, he has implied authority to make any contract or do any other act which is necessary or appropriate in the ordinary business of the corporation.¹¹² But his authority does not extend to any matters or transactions which are not properly incident to the management of the ordinary business.¹¹³ If he is intrusted with the management of a particular

¹⁰⁸ *Phillips v. Campbell*, 43 N. Y. 271; *Blake v. Domestic Mfg. Co.*, 64 N. J. Eq. 480, 38 Atl. 241; *Moore v. H. Gaus & Sons Mfg. Co.*, 113 Mo. 98, 20 S. W. 975; *Odd Fellows v. First Nat. Bank of Sturgis*, 42 Mich. 461, 4 N. W. 158; *Gafford v. American Mortgage & Investment Co.*, 77 Iowa 736, 42 N. W. 550.

¹⁰⁹ *Craft v. South Boston R. Co.*, 150 Mass. 207, 22 N. E. 920, 5 L. R. A. 641; *Jewett v. West Somerville Co-operative Bank*, 173 Mass. 54, 52 N. E. 1085, 73 Am. St. Rep. 259; *Brown v. Weymouth*, 36 Me. 414; *Adams v. Mills*, 60 N. Y. 533; *Alexander v. Cauldwell*, 83 N. Y. 480; *Chemical Nat. Bank v. Wagner*, 93 Ky. 525, 20 S. W. 535, 40 Am. St. Rep. 206; *In re Millward-Cliff Cracker Co.*, 161 Pa. St. 157, 28 Atl. 1072; *Winsted Hosiery Co. v. New Britain Knitting Co.*, 69 Conn. 565, 38 Atl. 688.

¹¹⁰ *Craft v. South Boston R. Co.*, 150 Mass. 207, 22 N. E. 920, 5 L. R. A. 641; *Adams v. Mills*, 60 N. Y. 533.

¹¹¹ *Jacobus v. Jamestown Mantel Co.*, 211 N. Y. 154, 161, 105 N. E. 210 (a treasurer of a manufacturing corporation has no power to make promissory notes in its name, unless such power is given by the by-laws

of the corporation or by resolution of its board of directors). *In re Millward-Cliff Cracker Co.*, 161 Pa. St. 157, 28 Atl. 1072; *Craft v. South Boston R. Co.*, 150 Mass. 207, 22 N. E. 920, 5 L. R. A. 641; *Bradlee v. Warren Five Cents Sav. Bank*, 127 Mass. 107, 34 Am. Rep. 351; *Jewett v. West Somerville Co-operative Bank*, 173 Mass. 54, 52 N. E. 1085, 73 Am. St. Rep. 259; *Blake v. Domestic Mfg. Co.*, 64 N. J. Eq. 480, 38 Atl. 241.

¹¹² *Biggerstaff v. Rowatt's Wharf*, [1896] 2 Ch. 93; *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 255; *Matson v. Alley*, 141 Ill. 284, 31 N. E. 419; *Seofield v. Parlin & Orendorff Co.*, 61 Fed. 804; *In re Grocer's Baking Co.*, 266 Fed. 900; *Pickens Co. v. Thomas*, 152 Ga. 648, 111 S. E. 27, 21 A. L. R. 1438; *Frost v. Domestic Sewing Machine Co.*, 133 Mass. 563; *Sarmiento v. Davis Boat & Oar Co.*, 105 Mich. 300, 63 N. W. 205, 55 Am. St. Rep. 446; *Allen Gravel Co. v. Mix*, 129 Miss. 809, 93 So. 244; *Pratt v. Oshkosh Match Co.*, 89 Wis. 406, 62 N. W. 84; 1 *Mechem, Agency* (2nd Ed.), sec. 980; 3 *Fletcher, Corporations*, sec. 2098.

¹¹³ *Dale v. Donaldson Lumber Co.*, 48 Ark. 188, 2 S. W. 703, 3 Am. St.

branch of the business only, his authority does not extend beyond such contracts and acts as are incident to the management of that particular branch. As a rule, a general manager of a corporation, intrusted with the entire management and control of its business, has implied power to borrow money for the legitimate purposes of the corporation in its current and usual business.¹¹⁴ But there is no such authority in the case of a mere superintendent, or in the case of a manager who has not the entire charge of the business, but is intrusted with its management under the direct control of the directors or other superior officers or agents.¹¹⁵ As a rule, he has implied authority to purchase supplies and materials, necessary office furniture, machinery, etc., for the use of the corporation in its business, unless there are restrictions on his powers in its management; ¹¹⁶ to rent necessary premises for the offices or other business purposes of the corporation; ¹¹⁷ to employ necessary clerks, servants, laborers, etc., and appoint necessary agents, and agree upon their compensation.¹¹⁸ He has no authority, however, to sell and convey or lease the real estate of the corporation, unless specially empowered to do so,¹¹⁹ or to make an assignment of all the property for the benefit of creditors.¹²⁰

Rep. 224; *Potts v. Wallace*, 146 U. S. 689, 36 L. Ed. 1135, 13 Sup. Ct. 196; *First Nat. Bank of Springfield v. Asheville Furniture & Lumber Co.*, 116 N. C. 827, 21 S. E. 948; *New Haven & Northampton Co. v. Hayden*, 107 Mass. 525.

¹¹⁴ *G. V. B. Mining Co. v. First Nat. Bank of Hailey*, 95 Fed. 23; *Rosemond v. Northwestern Auto-graphic Register Co.*, 62 Minn. 374, 64 N. W. 925, *Matson v. Alley*, 141 Ill. 284, 31 N. E. 419. But see *Sedalia Nat. Bank v. Economy Steam Heating & Electric Co.*, 145 Mo. App. 319, 180 S. W. 377.

¹¹⁵ *Adrian v. Roome*, 52 Barb. (N. Y.) 399; *Union Gold Min. Co. v. Rocky Mountain Nat. Bank*, 2 Colo. 565; *Breed v. First Nat. Bank of Central City*, 4 Colo. 481; *Madill Oil & Cotton Co. v. City Nat. Bank*, 74 Okla. 322, 193 Pac. 878.

¹¹⁶ *Castle v. Belfast Foundry Co.*, 72 Me. 167; *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 355; *Matson v. Alley*, 141 Ill. 284, 31 N. E. 419; *Powder River Live Stock Co. v. Lamb*, 38 Neb. 339, 56 N. W. 1019; *Pratt v. Oshkosh Match Co.*, 89 Wis. 406, 62 N. W. 84.

¹¹⁷ *Baltimore & Philadelphia Steamboat Co. v. McCutcheon & Collins*, 13 Pa. St. 13; *William Wicke Co. v. Kaldenberg Mfg. Co.*, 21 N. Y. Misc. 79, 46 N. Y. Supp. 937; *Singer Mfg. Co. v. McLean*, 105 Ala. 316, 16 So. 912; *Hawley v. Gray Bros. Artificial Stone Paving Co.*, 106 Cal. 337, 39 Pac. 337.

¹¹⁸ *Ceeder v. H. M. Loud & Sons Lumber Co.*, 86 Mich. 541, 49 N. W. 575, 24 Am. St. Rep. 134; *Hooker v. Eagle Bank of Rochester*, 30 N. Y. 83, 86 Am. Dec. 351; *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 355; *Tennessee River Transp. Co. v. Kavanaugh*, 101 Ala. 1, 13 So. 283; *Calvert v. Idaho Stage Co.*, 25 Ore. 412, 36 Pac. 24; *Hardy v. Tittabawassee Boom Co.*, 52 Mich. 45, 17 N. W. 235.

¹¹⁹ *Stow v. Wyse*, 7 Conn. 214, 18 Am. Dec. 99; *Gillis v. Bailey*, 17 N. H. 18; *Hartford Iron Min. Co. v. Cambria Min. Co.*, 80 Mich. 491, 45 N. W. 351; *Schetter v. Southern Oregon Imp. Co.*, 19 Ore. 192, 24 Pac. 25.

¹²⁰ See *Norton v. Alabama Nat. Bank*, 102 Ala. 420, 14 So. 872; *Hadden v. Linville*, 86 Md. 210, 38

The fact that a person who is appointed general manager of a corporation is also its president, or secretary, or treasurer, etc., does not operate at all as a limitation on his powers as general manager.¹²¹

Cashiers of banks.—By custom, the cashier of a bank is the general agent of the bank in dealings with customers in money, notes, and bills, and has charge, as general managing officer, of all its ordinary business. And his implied authority, therefore, extends to all matters which relate to the usual business of such corporations.¹²²

III. WHEN CORPORATION IS BOUND BY REPRESENTATIVES.

§ 110. **Estoppel of a corporation to deny authority of officers and agents.**—If a corporation clothes an officer or agent with apparent authority to act for it in a particular matter, it will be estopped to deny such authority as against persons dealing with him in good faith, and in ignorance of limitations upon his authority. And when an officer or agent is intrusted with the general management of the business of a corporation, or of a particular part of the business, he has apparent or implied authority to manage the same in the usual way, and for such purpose to bind the corporation by his acts and contracts on its behalf.

An officer or agent has no implied authority to bind the corporation by ultra vires contracts or acts, unless the corporation has clothed him with apparent authority by allowing him to do so.

Nor has an officer any implied authority to make contracts or act for his personal benefit. If he does so, persons dealing with him must make inquiry, or they will act at their peril.

A corporation is subject to the same extent as a natural person to the general principle that one who holds out another, or allows him to appear as having authority to act, as his agent with respect to his business generally, or with respect to a particular matter, is estopped, as against persons dealing with him in good faith, to deny that his apparent authority is real. If a corporation, therefore, or its directors, either intentionally or negligently, clothe a

Atl. 37, 900; *Cupit v. Park City Bank*, 20 Utah 293, 58 Pac. 839.

¹²¹ *Ceeder v. H. M. Loud & Sons Lumber Co.*, 86 Mich. 541, 49 N. W. 575, 24 Am. St. Rep. 134.

¹²² *Fleckner v. Bank of United States*, 8 Wheat. (U. S.) 338, 5 L. Ed. 631; *Merchants' Bank v. State Bank*, 10 Wall. (U. S.) 604, 19 L.

Ed. 1008; *First Nat. Bank of Silverton, Colo. v. Mercantile Nat. Bank of Pueblo, Colo.*, 273 Fed. 119; *Ryan v. Dunlap*, 17 Ill. 40, 63 Am. Dec. 334; *Corser v. Paul*, 41 N. H. 24, 77 Am. Dec. 753; *Coats v. Donnell*, 94 N. Y. 168; *Cochecho Nat. Bank v. Haskell*, 51 N. H. 116, 19 Am. Rep. 67.

particular officer or agent with an apparent authority to act for it in a particular business or transaction, and persons deal with him in good faith, it will be bound to the same extent precisely as if such apparent authority were real.¹²³ In such a case, the corporation cannot set up secret instructions or rules limiting the apparent authority of its agent.¹²⁴

A corporation is not estopped to deny the authority of a person acting as its agent, without authority in fact, as against one who relied, not on any appearance of authority, but merely on the representations of the person himself; and it can make no difference that the pretended agent had apparent authority in writing not known to the other party.¹²⁵ When an officer of a corporation is dealing for himself, to the knowledge of the other party, and also assumes to act for and bind his corporation, such fact is sufficient to put the other party upon inquiry as to his power to act for the corporation; and, as a general rule, if the other party deals with the officer without making inquiry as to his authority to bind the corporation, he does so at his peril.¹²⁶ A corporation may recover from a bank money paid from its funds by its former president and general manager on his personal debt to the bank, where the checks upon their face told the bank that it was the company's money, and not his own money that it was receiving from him in payment of his personal indebtedness. The bank has no right to assume that the president had any such authority to use the funds of the company to pay his private debts.¹²⁷

¹²³ *Newton v. Johnston Organ & Piano Mfg. Co.*, 180 Cal. 185, 180 Pac. 7; *Sigel-Campion Livestock Commission Co. v. Ardohain*, 71 Colo. 410, 207 Pac. 82.

¹²⁴ *Hatch v. Coddington*, 95 U. S. 48, 24 L. Ed. 339; *Fitzgerald & Mal-lory Const. Co. v. Fitzgerald*, 137 U. S. 98, 34 L. Ed. 608, 11 Sup. Ct. 36.

¹²⁵ *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379.

¹²⁶ *Moores v. Citizens' Nat. Bank of Piqua*, 111 U. S. 156, 28 L. Ed. 385, 4 Sup. Ct. 345; *First Nat. Bank of Sweetwater, Tex. v. Rush*, 257 Fed. 29; *Farrington v. South Boston R. Co.*, 150 Mass. 406, 23 N. E. 109, 5 L. R. A. 849, 15 Am. St. Rep. 222; *Wilson v. Metropolitan El. R. Co.*, 120 N. Y. 145, 24 N. E. 384, 17 Am. St. Rep. 625; *Hanover Nat. Bank of City of New York v. American Dock & Trust Co.*, 148 N. Y. 612, 43 N. E.

72, 51 Am. St. Rep. 721; *Chemical Nat. Bank of New York v. Wagner*, 93 Ky. 525, 20 S. W. 535, 40 Am. St. Rep. 206; *Wheeler v. Home Savings & State Bank*, 188 Ill. 34, 58 N. E. 598, 80 Am. St. Rep. 161; *Fletcher, Corporations*, sec. 1929 (notice from individual or adverse interest of officer or agent).

¹²⁷ *First Nat. Bank of El Reno v. Gillette*, 52 Okla. 341, 152 Pac. 1084 (one receiving a corporate check from the officer of a corporation in payment of his personal debt is put on inquiry as to his authority to issue such checks). See also *Wagner Trading Co. v. Battery Park Nat. Bank*, 228 N. Y. 37, 126 N. E. 347; 9 A. L. R. 340, 347n.

Checks payable to corporation should not be deposited in officer's personal account. A bank is liable to the corporation where an officer

Restrictions in charter, general law and by-laws.—All persons dealing with the officers of a corporation are chargeable with notice of limitations upon their authority imposed by the charter, articles of incorporation or general laws.¹²⁸ And it is said in some of the cases that persons dealing with the officers of a corporation are chargeable with notice of by-laws limiting their authority.¹²⁹ This, however, is not the general rule. By the weight of authority, if a corporation clothes an officer or agent with apparent authority to bind it by a particular contract or act, it cannot escape liability by setting up limitations or restrictions upon his authority contained in by-laws not known to the other party, for persons dealing with the officers or agents of a corporation, acting within their apparent authority, are not bound to ascertain whether such apparent authority is restricted by the by-laws.¹³⁰ They are regarded as mere internal regulations, binding as between the corporation, its officers and members; but third persons dealing with an agent or representative may rely upon his ostensible authority and are not bound by secret limitations or instructions.

It was held, however, in *Bloomingdale v. Cushman*,¹³¹ that where a corporation denies the execution of certain promissory notes, the plaintiffs are chargeable with notice of the statute under which the company was incorporated; and since the statute requires the company to prescribe the duties of its officers either in the certificate of corporation, or in its by-laws, plaintiffs are chargeable with notice

indorses a check payable to the order of the corporation and deposits them in his own account in the defendant bank. *Dennis Metal Mfg. Co. v. Fidelity Union Trust Co.*, 99 N. J. Law 365, 123 Atl. 614. See *Hill Syrup Co. v. Frederick & Nelson*, 133 Wash. 155, 233 Pac. 663. See also 9 Minnesota Law Rev. 678; 75 Uni. Pennsylvania Law Rev. 64.

¹²⁸ *Homersham v. Wolverhampton Waterworks Co.*, 6 Exch. 137; *Relfe v. Rundle*, 103 U. S. 222, 26 L. Ed. 337; *Louisville Trust Co. v. Louisville, N. A. & C. R. Co.*, 75 Fed. 433; *Couch v. City Fire Ins. Co.*, 38 Conn. 181, 9 Am. Rep. 375; *Bocock's Ex'r v. Alleghany Coal & Iron Co.*, 82 Va. 913, 1 S. E. 325, 3 Am. St. Rep. 128.

¹²⁹ *Relfe v. Rundle*, 103 U. S. 222, 26 L. Ed. 337; *Bocock's Ex'r v. Alleghany Coal & Iron Co.*, 82 Va. 913, 1 S. E. 325, 3 Am. St. Rep. 128;

Putnam v. Ensign Oil Co., 272 Pa. 301, 116 Atl. 285. See *Stevens*, 36 Yale Law Journal 326; post, § 183.

¹³⁰ *Smith v. Smith*, 62 Ill. 493; *Wait v. Smith*, 92 Ill. 385; *Moyer v. East Shore Terminal Co.*, 41 S. C. 300, 19 S. E. 651, 25 L. R. A. 48, 44 Am. St. Rep. 709; *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 355; *Powers v. Schlicht Heat, Light & Power Co.*, 165 N. Y. 662, 59 N. E. 1129; *Johnston v. Milwaukee & W. Inv. Co.*, 46 Neb. 480, 64 N. W. 1100; *Barnes v. Black Diamond Coal Co.*, 101 Tenn. 354, 47 S. W. 498; *Eastern Shore Brokerage & Commission Co. v. Harrison*, 141 Md. 91, 118 Atl. 192; *Hartford v. Massachusetts Bowling Alleys*, 229 Mass. 30, 118 N. E. 188.

¹³¹ 134 Minn. 445, 159 N. W. 1078. See 7 R. C. L., Corporations, sec. 437.

of the powers of such officers as so prescribed. The by-laws in this case provided that all notes given by the company should be signed by the president and by the secretary. The notes in suit were executed only by the president without the knowledge of the corporation, and solely for the accommodation of a third party. They had never been ratified by the corporation. The plaintiffs, although holders "in due course," must show that the officers executing them had express, implied, or apparent authority to execute notes for the corporation. If the notes had been executed by officers who had general authority to execute notes on behalf of the company, they would probably have been valid in the hands of a holder "in due course," although the company had received no consideration for them.

Ultra vires acts and contracts.—A corporation, although it has no right to do so, has the capacity to authorize its officers and agents to make *ultra vires* contracts, so as to incur liability thereon under circumstances shown in another chapter.¹³² And authority on the part of the officers or agents to engage in *ultra vires* transactions in the name of the corporation may be implied, if it appears that the stockholders or directors have allowed them to do so.¹³³ Thus, although a bank may not have the power under its charter to receive special deposits as bailee, it may exceed its powers in this respect; and if the stockholders and directors habitually suffer the cashier to receive special deposits, authority on his part to do so will be implied, so as to render the bank liable for his act.¹³⁴ It is well settled, however, that no such authority will be implied merely from the fact that an officer or agent has been authorized or allowed to manage the business of the corporation, for it is to be presumed, in the absence of evidence to the contrary, that it was intended that he should manage it within the limits imposed by its charter.¹³⁵

¹³² See ante, §§ 70, 79; *First Nat. Bank v. Graham*, 79 Pa. St. 106, 21 Am. Rep. 49, aff'd 100 U. S. 699, 25 L. Ed. 750 (in general, charter purposes and restrictions are limitations upon the actual authority of officers and agents). See also, *N. A. Berwin & Co. v. Hewitt Realty Co.*, 199 N. Y. App. Div. 453, 191 N. Y. Supp. 817; *Wagner v. Central Banking & Security Co.*, 249 Fed. 145.

¹³³ *State v. Commercial Bank of Manchester*, 6 Smedes & M. (Miss.) 218, 45 Am. Dec. 280; *Lloyd v. West*

Branch Bank, 15 Pa. St. 172, 53 Am. Dec. 581.

¹³⁴ *Lloyd v. West Branch Bank*, 15 Pa. St. 172, 53 Am. Dec. 581; *First Nat. Bank of Carlisle v. Graham*, 79 Pa. St. 106, 21 Am. Rep. 49, aff'd 100 U. S. 699, 25 L. Ed. 750; *First Nat. Bank of Monmouth v. Strang*, 138 Ill. 347, 27 N. E. 903; *Foster v. Essex Bank*, 17 Mass. 479, 9 Am. Dec. 168.

¹³⁵ *Hall v. Auburn Turnpike Co.*, 27 Cal. 255, 87 Am. Dec. 75; *McLellan v. Detroit File Works*, 56 Mich. 579, 23 N. W. 321; *Lucas v.*

§ 111. Ratification of unauthorized acts and contracts.—Any act on the part of the officers or agents of a corporation or third persons, without authority, but which might have been authorized, may be ratified by the same authority by which it might have been authorized, subject to express charter or statutory provisions. And, as a rule, if the corporation, having knowledge of the facts, fails to repudiate the act, or accepts the benefit of it, or acts upon or recognizes it, a ratification will be implied, unless some particular mode of action is necessary to confer authority to do the act. Ratification is equivalent to original authority, except as to intervening rights, and the same authority and mode of action is necessary to a ratification as is required for original authority.

If the officers of a corporation or other persons assume to act for the corporation without any authority at all, or if they exceed their authority, or act irregularly, and the act is one which could have been authorized in the first instance by the stockholders, board of directors, or subordinate officers, as the case may be, it may be expressly or impliedly ratified by them, and thus be rendered just as binding, except as to intervening rights of third persons, as if it had been authorized when done, or done regularly. In this respect, a corporation is subject to substantially the same rules as a natural person.¹³⁶ Of course, unauthorized or irregular contracts or other acts by the officers or agents of a corporation cannot be ratified except by a person or persons having authority to authorize the same, and bind the corporation. Obviously, an officer or officers who have no power to do or authorize an act have no power to ratify such an act.¹³⁷ The stockholders of a corporation may ratify and render valid acts done or authorized by the board of directors, but which were beyond the powers of the directors, or acts done or authorized by the directors at an illegal meeting, or unauthorized acts of others than the directors, provided the acts are such as may be done or authorized by the stockholders.¹³⁸ But the stockholders

White Line Transfer Co., 70 Iowa 541, 30 N. W. 771, 59 Am. Rep. 449; First Nat. Bank of Allentown v. Hoch, 89 Pa. St. 324, 33 Am. Rep. 769.

¹³⁶ Mercer v. Steil, 97 Conn. 583, 117 Atl. 689; Frick v. Rockwell City Canning Co., 192 Iowa 11, 181 N. W. 475.

¹³⁷ Lyndon Mill Co. v. Lyndon Literary & Biblical Institute, 63 Vt.

581, 22 Atl. 575, 25 Am. St. Rep. 783; Appeal of Crum, 66 Pa. St. 474; Tracy v. Guthrie County Agricultural Society, 47 Iowa 27.

¹³⁸ Sewell's Case, 3 Ch. App. 131; Eidman v. Bowman, 58 Ill. 444, 11 Am. Rep. 90; Ashley Wire Co. v. Illinois Steel Co., 164 Ill. 149, 46 N. E. 410, 56 Am. St. Rep. 187; Johnson Co. v. Miller, 174 Pa. St. 605, 34 Atl. 316, 52 Am. St. Rep. 833; Stain-

cannot bind the corporation by ratification of an act which, under the charter of the corporation, is within the exclusive authority of the directors.¹³⁹

A contract made or other act done by an officer or officers of a corporation without authority may be ratified in any mode in which it might have been authorized. It need not be under the corporate seal, nor by formal vote of the stockholders or directors, as the case may be, unless this would have been necessary to authorize the contract or act in the first instance; but, as in the case of ratification by a natural person, it may be by parol, or may be implied from the conduct of the corporation, or of officers having authority to ratify, in accepting the benefits, with knowledge of the facts, or otherwise treating or recognizing the contract or act as binding; and under some circumstances it may be implied from a mere failure to repudiate or disaffirm the same.¹⁴⁰

§ 112. Notice to or knowledge of officers or agents as notice to or knowledge of corporation.—Notice to or knowledge of an officer or agent of a corporation while acting within the course of his employment, and with respect to a matter within the scope of his authority, or apparent authority, is notice to the corporation.

There is some conflict of opinion as to when knowledge of facts upon the part of an officer or agent of a corporation is notice to the corporation. The following propositions, however, are established by the weight of authority:

- (1) Knowledge of facts acquired or possessed by an officer or agent of a corporation in the course of his employment, and in relation to matters within the scope of his authority, is notice to the corporation, whether he communicates such knowledge or not.
- (2) But a corporation is not chargeable with notice of facts acquired or possessed by an officer or agent otherwise than in the course of his employment, or in relation to matters which are not within the scope of his authority.

back v. Junk Bros. Lumber & Mfg. Co., 98 Tenn. 306, 39 S. W. 530; Pneumatic Gas Co. v. Berry, 113 U. S. 322, 28 L. Ed. 1003, 5 Sup. Ct. 525; Bensiak v. Thomas, 66 Fed. 104.

¹³⁹ Union Gold Min. Co. v. Rocky Mountain Nat. Bank, 2 Colo. 565; Blood v. La Serena Land & Water Co., 113 Cal. 221, 41 Pac. 1017, 45 Pac. 252. But see ante, § 100.

¹⁴⁰ Standard Roller Bearing Co. v. Hess-Bright Mfg. Co., 275 Fed. 916; In re National Piano Co., 252 Fed. 950; In re Grocers' Baking Co., 266 Fed. 900; Milligan v. G. D. Milligan Grocery Co., 207 Mo. App. 472, 233 S. W. 506.

- (3) As a rule, a corporation is not chargeable with notice of facts because of knowledge on the part of an officer or agent, where the latter is dealing with the corporation in his own interest, or where, for any other reason, his interest in the matter is adverse to that of the corporation, so that communication of the knowledge by him cannot be presumed.
- (4) But, by the weight of authority, when an officer of a corporation does an act which constitutes a fraud upon a third person, or upon another corporation, of which he is also an officer, the first-mentioned corporation is chargeable with notice of the nature of the transaction, although the fraud is perpetrated for his own benefit, where he also represents the corporation in the transaction.

Whether knowledge possessed by an officer or agent of a corporation is notice to or knowledge of the corporation depends upon the circumstances. "A corporation cannot see or know anything except by the eyes or intelligence of its officers";¹⁴¹ and it is well settled, therefore, in most jurisdictions, that if an officer or agent of a corporation acquires or possesses knowledge of facts, in the course of his employment, and as to matters which are within the scope of his authority, his knowledge is imputable to the corporation.¹⁴² But knowledge acquired or possessed by an officer or agent of a corporation otherwise than in the course of his employment, or in relation to a matter which is not within the scope of his authority, is not notice to the corporation. Such information, however, will bind the principal when it is present in his mind while he is acting for the principal, although acquired outside the scope of his duties or before the creation of the agency.¹⁴³ "This is clear," it was said in a New York case, "from the ground and reason upon which the doctrine of notice to the principal through the agents rests. The principal is chargeable with this knowledge for the reason that the agent is substituted in his place, and represents him in the particular transaction; and as this relation, strictly

¹⁴¹ *Factors' & Traders' Ins. Co. v. Marine Dry Dock & Shipyard Co.*, 31 La. Ann. 149.

¹⁴² *Wireless Specialty Apparatus Co. v. Mica Condenser Co.*, 239 Mass. 158, 131 N. E. 307, 6 A. L. R. 170; *Gardiner v. Equitable Office Bldg. Corp.*, 273 Fed. 441, 17 A. L.

R. 431. See *Seavey*, 65 U. of Pa. Law Rev. 1.

¹⁴³ *Guaranty Inv. Loan Co. v. Athens Engineering Co.*, 152 Ga. 596, 110 S. E. 873; *John H. Giles Dyeing Mach. Co. v. Klander-Weldon Co.*, 233 N. Y. 470, 135 N. E. 854.

speaking, exists only while the agent is acting in the business thus delegated to him, it is proper to limit it to such occasions."¹⁴⁴

Notice to or knowledge of directors.—Since the directors of a corporation collectively represent the corporation, and have general supervision and control over its affairs, a corporation clearly has notice of facts when knowledge thereof is communicated by one of them to the others, or by a third person, or knowledge is otherwise possessed by them, at a meeting of the board.¹⁴⁵ Whether or not a corporation is chargeable with notice of facts as to which individual directors have knowledge is not clear, and the decisions on the question are conflicting. By the weight of authority, however, since the directors do not individually represent the corporation, and have no power to bind it, except collectively and as a board, notice of facts casually acquired by individual directors, when they do not communicate their knowledge to the other directors or officers, and do not act officially in the matter, is not notice to the corporation.¹⁴⁶

It has been held, however, that where notice is given to a director of a corporation officially, for the purpose of its being communicated to the board, it is notice to the corporation, whether it is communicated to the board or not. And by the weight of authority, knowledge possessed by a director, who is present and acting at a meeting of the board, whensoever or howsoever it may have been acquired, is notice to the corporation, whether he communicates his knowledge to the board or not, for in such a case he has the knowledge while acting officially, and it is his duty to communicate it.¹⁴⁷

¹⁴⁴ *Bank of United States v. Davis*, 2 Hill (N. Y.) 451; *Title Guarantee & Trust Co. v. Pam*, 232 N. Y. 441, 134 N. E. 525; *Corrigan v. Bobbs-Merrill Co.*, 228 N. Y. 58, 126 N. E. 260, 10 A. L. R. 662: "Two things must concur, viz., the possession by the agent of pertinent information and his personal participation in respect thereto on behalf of his corporation."

¹⁴⁵ *Bank of Pittsburgh v. Whitehead*, 10 Watts (Pa.) 397, 36 Am. Dec. 186; *Farmers' & Citizens' Bank v. Payne*, 25 Conn. 444, 68 Am. Dec. 362; *Union Bank v. Campbell*, 4 Humph. (Tenn.) 394; *City Bank of Columbus v. Phillips*, 22 Mo. 85, 64 Am. Dec. 254.

¹⁴⁶ *Reynolds v. Third Nat. Bank of St. Louis*, — Mo. —, 225 S. W. 901. See *Title Guarantee & Trust Co. v. Pam*, 232 N. Y. 441, 134 N. E. 525.

¹⁴⁷ *Union Bank v. Campbell*, 4 Humph. (Tenn.) 394; *Toll Bridge Co. v. Betsworth*, 30 Conn. 380; *Bank of United States v. Davis*, 2 Hill (N. Y.) 451; *North River Bank v. Aymar*, 3 Hill (N. Y.) 262; *National Security Bank v. Cushman*, 121 Mass. 490; *City Bank of Columbus v. Phillips*, 22 Mo. 85, 64 Am. Dec. 254. See *Botna Valley State Bank v. Greig*, 182 Iowa 662, 166 N. W. 104.

Knowledge of officer dealing with corporation, or otherwise interested adversely.—The doctrine that a principal is chargeable with notice of facts known to his agent is based upon the ground that it is the duty of the agent to communicate his knowledge to the principal, and that it is to be presumed that he has performed this duty; and, as a rule, this presumption is conclusive. No such presumption can arise, however, where the agent is dealing with the principal in his own interest, or where, for other reasons, his interest is adverse to that of his principal, so that it is to his own interest not to impart his knowledge to the principal; and in such a case the doctrine does not apply. It is well settled, therefore, as a general rule, that where a director or other officer is dealing with the corporation in his own behalf, or is, for any other reason, interested in a transaction adversely to the corporation, knowledge possessed by him in the transaction is not imputable to the corporation.¹⁴⁸

This doctrine applies, for example, where a director or other officer of a corporation sells and conveys or mortgages land to the corporation, having at the time knowledge of a prior unrecorded deed, lease, or mortgage, or of other defects in the title, or equities in favor of third persons, and the corporation acts by other representatives without notice;¹⁴⁹ and where a consignee of a cargo for sale as agent, having an absolute bill of lading in his own name, indorses the bill of lading and pledges the cargo to a bank in which he is a director, for a loan to himself, the loan being approved at a meeting of the directors at which he is present.¹⁵⁰ When a corporation deals with another corporation, of which its officer is also an officer or agent, or with a natural person, of whom he is also an agent, it is not chargeable with knowledge of facts possessed by him, if it does not relate to matters within his authority as officer, or if he is not acting as its agent in the matter.¹⁵¹

Fraud committed by officer upon a third person for his own benefit.—When the act of an officer of a corporation constitutes a fraud upon a third person, or upon another corporation of which

¹⁴⁸ *Gardiner v. Equitable Office Bldg. Corp.*, 273 Fed. 441, 17 A. L. R. 431.

¹⁴⁹ *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 182 Pac. 293; *Barnes v. Trenton Gas Light Co.*, 27 N. J. Eq. 33; *Wickersham v. Chicago Zinc Co.*, 18 Kan. 481, 26 Am. Rep. 784; *Frenkel v. Hudson*, 82 Ala. 158, 2 So. 753, 60 Am. Rep.

736; *Higgins v. Lansingh*, 154 Ill. 301, 40 N. E. 362.

¹⁵⁰ *Innerarity v. Merchants' Nat. Bank*, 139 Mass. 332, 1 N. E. 282, 52 Am. Rep. 710.

¹⁵¹ *In re Marseilles Extension Ry. Co.*, 7 Ch. App. 161; *First Nat. Bank of Rock Island v. Loyhed*, 28 Minn. 396, 10 N. W. 421.

he is also an officer, the first-mentioned corporation is chargeable with notice of the nature of the transaction, although the fraud is perpetrated for his own benefit, where he also represents the corporation in the transaction.¹⁵² In a Massachusetts case, where the treasurer of a corporation paid his deficit to it by drawing checks upon another corporation, of which he was also treasurer, no other officer of either corporation having knowledge of the true nature of the transaction when it occurred, it was held that the knowledge of the treasurer was imputable to the corporation receiving the checks, as he represented it in the transaction; and the receipt of the checks was therefore treated as wrongful, and as imposing a liability on the corporation to repay the amount to the other corporation.¹⁵³

§ 113. Declarations and admissions of officers and agents.—Declarations or admissions of an officer or agent of a corporation are the declarations and admissions of the corporation, and are admissible in evidence against it, if they were expressly authorized or have been ratified by the corporation, or, although not expressly authorized or ratified, if they were made by the officer or agent in the course of a transaction on behalf of the corporation, and within the scope of his authority, but not otherwise.

Declarations or admissions of an officer or agent of a corporation are not binding upon it, nor admissible in evidence against it for any purpose, unless they were made by the officer or agent in the course of a transaction on behalf of the corporation, and within the scope of his authority, or unless they were expressly authorized by the corporation, or have since been ratified by it.¹⁵⁴ But declarations or admissions of officers or agents are admissible in evidence against the corporation for any purpose for which, and under the same circumstances under which, declarations or admissions of a natural person are admissible against him, if they were expressly authorized by the corporation or its authorized officers, or if they have been ratified, or if, although neither expressly authorized nor ratified, they were made by the officer or

¹⁵² *Atlantic Bank v. Merchants' Bank*, 10 Gray (Mass.) 532; *Atlantic Cotton Mills v. Indian Orchard Mills*, 147 Mass. 268, 17 N. E. 496, 9 Am. St. Rep. 698; *In re Millward-Cliff Cracker Co.*, 161 Pa. St. 157, 28 Atl. 1072; *Detroit Motor Co. v. Third Nat. Bank*, 111 Mich. 407, 69 N. W. 726.

¹⁵³ *Atlantic Cotton Mills v. Indian Orchard Mills*, 147 Mass. 268, 17 N. E. 496, 9 Am. St. Rep. 698. See *First Nat. Bank v. Burns*, 88 Ohio St. 434, 103 N. E. 93, 49 L. R. A. (N. S.) 764; 39 Harvard Law Rev. 645.

¹⁵⁴ *Alabama Power Co. v. Talmadge*, 207 Ala. 86, 93 So. 548.

agent in the course of a transaction on behalf of the corporation, and within the scope of his general authority.¹⁵⁵

“The mere fact,” said the Minnesota court, “that one is a director, president, secretary, or other officer of a corporation, does not make all his acts or declarations, even though relating to the affairs of the corporation, binding upon the latter. Such persons are mere agents, and their declarations are binding upon the corporation only when made in the course of the performance of their authorized duties as agents, so that the declarations constitute a part of their conduct as agents,— a part of the *res gestae*.”¹⁵⁶ An officer or agent of a corporation, having authority to transact a particular business, or to superintend and manage generally the current business and dealings of the corporation, has, from such authority alone, no implied or incidental power to bind the corporation by declarations or admissions as to past events. The declarations or admissions are not admissible in evidence against the corporation unless they were made in the course of the transaction, so as to constitute part of the *res gestae*.¹⁵⁷

¹⁵⁵ *Rosenberger v. H. E. Wileox Motor Co.*, 145 Minn. 408, 177 N. W. 625.

¹⁵⁶ *Browning v. Hinkle*, 48 Minn. 544, 51 N. W. 605, 31 Am. St. Rep. 691.

¹⁵⁷ *First Nat. Bank v. Rust*, 257 Fed. 29; *Merchants' Nat. Bank v.*

Clark, 139 N. Y. 314, 319, 34 N. E. 910, 36 Am. St. Rep. 710, 712 (subsequent declarations and admissions by individual directors and officers of a bank are of no effect, as they have no authority to make declarations as to bygone transactions).

CHAPTER X.

DUTIES AND LIABILITIES OF DIRECTORS AND OFFICERS.

I. DUTY OF CARE IN MANAGEMENT.

§ 114. Responsibility in general.—The directors and other officers of a corporation are liable to the corporation for losses resulting from fraudulent acts, from acts in excess of the authority conferred upon them, or from their negligence in failing to exercise the care, skill, and diligence, in the management of the corporation and supervision of its affairs, which ordinarily skillful and prudent men would exercise under similar circumstances.

But they are not liable for losses resulting from mere mistakes, either of law or fact, or from errors of judgment on their part, if they have exercised ordinary care and skill, nor for the fraudulent or wrongful acts or neglect of subordinate officers or agents, where they have exercised ordinary care in selecting and supervising them.

It is sometimes said that the directors and other officers of a corporation are trustees for the corporation, or for the stockholders collectively.¹ If this means no more than that directors in the performance of their duties and the exercise of their agency on behalf of the corporation stand in a fiduciary relationship to the company, it is true enough. But the statement is misleading as a description of what the duties of a director are. There may be but little resemblance between the duties of a trustee under a will and the duties of a director. These duties will vary with the size of the business, the kind of corporation and what matters are properly delegated to the manager and other officials.² They are not "trustees" in the strict sense of the term. Properly speak-

¹ Robinson v. Smith, 3 Paige (N. Y.) 222, 24 Am. Dec. 212; Shea v. Mabry, 1 Lea (Tenn.) 319; Koehler v. Black River Falls Iron Co., 2 Black (U. S.) 715, 721, 17 L. Ed. 339; Bird Coal & Iron Co. v. Humes, 157 Pa. St. 278, 27 Atl. 750, 37 Am. St. Rep. 727; Ellis v. Ward, 137 Ill. 509, 25 N. E. 530; Williams v. McKay, 40 N. J. Eq. 189, 53 Am. St.

Rep. 775. See Imperial, etc., Hotel Co. v. Hampson, 23 Ch. Div. 1, 12; In re City Equitable Fire Ins. Co., [1925] Ch. 407, 427. Directors are called "trustees" in certain states, and very commonly in the case of religious and educational corporations.

² In re City Equitable Fire Ins. Co., [1925] Ch. 407, 427.

ing, the relation is that of principal and agent. As agents in control of its affairs, the directors of a corporation occupy a fiduciary relation to it which imposes upon them the duty to use the authority given them solely for the benefit of the corporation and its stockholders. The law does not permit them to appropriate its property to themselves nor to divert it to others nor suffer others to misappropriate it.³

It is important that directors realize the responsibility which they assume. They are expected to exercise an active and vigilant supervision over the officers of the company. They are expected to be familiar with the requirements of the by-laws of the corporation and enforce them. They are supposed to take the usual methods to inform themselves of the true condition of the affairs of the company. It is not a mere position of honor, void of responsibility, nor can prominent men safely lend their names as directors for the prestige and advertising value, upon an understanding that they are not expected to take an active part in the management and supervision.⁴ Their liability is not limited to wilful breaches of trust or excess of power, but extends also to negligence. By the weight of authority, if they are guilty of negligence in the performance of their duties, as in cases in which the directors of a bank or other corporation fail to hold meetings or exercise supervision over the affairs of the corporation, and, as a result of their neglect, the funds or property of the corporation are stolen, wasted, or lost, they are liable, for in assuming the duties of office, even though it be gratuitously, they are bound to exercise ordinary care and diligence in the discharge of their duties.⁵

³ Dawson v. National Life Ins. Co. of America, 176 Iowa 362, 157 N. W. 929, L. R. A. 1916 E 878, Ann. Cas. 1918 B 230; Lake Harriet State Bank of Minneapolis v. Venie, 138 Minn. 339, 165 N. W. 225; Bosworth v. Allen, 168 N. Y. 157, 61 N. E. 163, 55 L. R. A. 751, 85 Am. St. Rep. 667 (liable to account in equity as trustees).

⁴ Kavanaugh v. Commonwealth Trust Co. of New York, 223 N. Y. 103, 119 N. E. 237, aff'g 147 N. Y. App. Div. 281, 131 N. Y. Supp. 1059. It was understood that Gec. J. Gould, when elected as director, was not expected to attend meetings or take an active part in the affairs

of the corporation. The court held that no custom, practice or understanding can excuse a director from the exercise of such care and prudence as men exercise in their own affairs. The law has no place for dummy directors. See Liability of Corporate Directors, F. Dwight, 17 Yale Law Journal 33 (an argument for a stricter standard of responsibility for directors); Diligence of Directors in Management of Corporations, M. C. Lynch, 3 California Law Rev. 21; Liability of the Inactive Corporate Director, Cushing, 8 Columbia Law Rev. 18.

⁵ Briggs v. Spaulding, 141 U. S. 132, 35 L. Ed. 662, 11 Sup. Ct. 924;

The director of a corporation cannot remain silent, when he knows that a fraud is being attempted against the corporation and ultimately against its shareholders. It is his duty to acquaint the other officers of the corporation with the facts and to use every effort to prevent the consummation of the fraud. If he permits by passive acquiescence any part of the assets of the corporation to be fraudulently diverted or secret profits to be obtained he is guilty of a neglect of duty to the corporation for which he is liable in damages, notwithstanding the fact that he did not profit financially thereby.^{5a}

§ 115. Degree of care and diligence required.

There has been some difference in the expressions used by the courts to designate the degree of care and diligence required of the directors and other officers of a corporation in the management or supervision of its affairs, and it is difficult to tell whether the differing standards make a difference in practical application. "They can only be regarded," said Judge Sharswood in a leading case, "as mandatories—persons who have gratuitously undertaken to perform certain duties, and who are therefore bound to apply ordinary skill and diligence, but no more." In this case of *Sperling's Appeal*,⁶ an assignee for creditors of a trust company sued to compel directors to make good losses due to mismanagement. The affairs of the trust company were very unwisely managed. Loans were made on doubtful collateral. They sought to realize large profits at usurious rates of interest. They lost from a failure to insure. It was held in a somewhat lax decision that the di-

Hun v. Cary, 82 N. Y. 65, 37 Am. St. Rep. 546; *Chicago Title & Trust Co. v. Munday*, 297 Ill. 555, 131 N. E. 103. See *General Rubber Co. v. Benedict*, 215 N. Y. 18, 109 N. E. 96, L. R. A. 1915 F 617.

In *Gibbons v. Anderson*, 80 Fed. 345, 349, it is said: "It is the right and duty of the board to maintain a supervision of the affairs of the bank; to have a general knowledge of the manner in which its business is conducted, and of the character of that business; and to have at least such a degree of intimacy with its affairs as to know to whom, and upon what security, its large lines of credit are given. . . . They are not expected to watch the routine of every day's business, or ob-

serve the particular state of the accounts, unless there is special reason; nor are they to be held for any sudden and unforeseen dereliction of executive officers. . . . The idea is not to be tolerated that they serve merely as gilded ornaments of the institution."

^{5a} *Reid v. Robinson*, 64 Cal. App. 46, 220 Pac. 676; *General Rubber Co. v. Benedict*, 215 N. Y. 18, 109 N. E. 96.

⁶ 71 Pa. St. 11, 10 Am. Rep. 684. See *Rhodes*, Personal liability of directors for corporate mismanagement, 65 Univ. Pennsylvania Law Rev. 128; *Dwight*, 17 Yale Law Journal 337; *A. S. Bolles*, Duty and liability of bank directors, 12 Yale Law Journal 287.

rectors were not liable for honest mistakes of judgment, although so gross as now to appear absurd and ridiculous, if fairly within the scope of the discretion confided to them.

It is often said that the directors are only liable for "gross negligence," but this does not give any definite standard. What would be properly regarded as very slight negligence in the case of a railroad or manufacturing company might well be regarded as very gross negligence in the case of a bank. The only proper rule is that the directors are liable on the ground of negligence when, and only when, they have failed to exercise ordinary care and diligence; and ordinary care and diligence is such care and diligence as ordinarily careful and prudent men generally exercise under similar circumstances. What is a failure to exercise ordinary care and diligence is always to be determined with reference to the circumstances of the particular case. If, under those circumstances, it can be said that the directors have failed to exercise such a degree of care, they have been guilty of culpable negligence, and are liable.⁷ A director of a national bank who wilfully fails to attend the meetings of the board of directors and inform himself of the condition of its affairs is guilty of a breach of his common-law obligation to exercise at least ordinary care and prudence in the supervision and administration of the bank's affairs. The fact of his residence at a distance from the bank is no excuse from the responsibility.⁸ In *Hun v. Cary*,⁹ the trustees of a savings bank which was substantially insolvent invested nearly half of the available funds in an expensive lot with an obligation to erect thereon an extravagant building which took most of the balance of the funds. It was not necessary, but was intended as a sort of advertisement of the bank to attract deposits. It was held that this evidence justified a finding by the jury that the trustees had failed to exercise ordinary care and prudence in making this investment under the circumstances, and were liable for damages caused by their misconduct.

⁷ *Kavanaugh v. Commonwealth Trust Co. of New York*, 223 N. Y. 103, 119 N. E. 237; *Hun v. Cary*, 82 N. Y. 65, 37 Am. Rep. 546; *Briggs v. Spaulding*, 141 U. S. 132, 35 L. Ed. 662, 11 Sup. Ct. 924; *King v. Livingston Mfg. Co.*, 192 Ala. 269, 68 So. 897; *Bowerman v. Hamner*, 250 U. S. 504, 63 L. Ed. 1113, 39 Sup. Ct. 549. See *General Rubber*

Co. v. Benedict, 215 N. Y. 18, 109 N. E. 96, L. R. A. 1915F 617.

⁸ *Bowerman v. Hamner*, 250 U. S. 504, 63 L. Ed. 1113, 39 Sup. Ct. 549, aff'g 241 Fed. 737. Compare *Wallach v. Billings*, note 10, *infra*. See 4 *Minnesota Law Rev.* 232.

⁹ 82 N. Y. 65. The court criticised the lax standard applied in *Sperling's Appeal*, *supra*, note 6.

Neither the directors nor the other officers of a corporation are liable for honest mistakes or errors of judgment, where they have brought to the discharge of their duties and exercised such a degree of attention, care, skill, and judgment as ordinarily prudent and diligent men would exercise under similar circumstances.¹⁰ But the rule exempting officers of corporations from liability for mere mistakes and errors of judgment does not apply where the loss is the result of failure to exercise proper care, skill, and diligence. "Directors are not merely bound to be honest; they must also be diligent and careful in performing the duties they have undertaken. They cannot excuse imprudence on the ground of their ignorance or inexperience, or the honesty of their intentions; and, if they commit an error of judgment through mere recklessness, or want of ordinary prudence and skill, the corporation may hold them responsible for the consequences."¹¹ In *Fell v. Pitts*,¹² a trustee in bankruptcy of a corporation recovered against a director for the declaration of a dividend out of capital. The defendant took no active part in the management of the corporation and seldom attended meetings of the board, although a director for 6 years. It was held that directors are liable jointly and severally for failure to exercise reasonable and ordinary skill and diligence in supervising and conducting the business of the corporation. Reasonable investigation would have disclosed the absence of net earnings. The directors acted without any report or inquiry as to the financial condition.

¹⁰ *United Zinc Co. v. Harwood*, 216 Mass. 474, 103 N. E. 1037, Ann. Cas. 1915 B 948.

In *Wallach v. Billings*, 277 Ill. 218, 115 N. E. 382, L. R. A. 1918 A 1097, it is held that a nonresident director of a national bank who was the only member of the board not under the control of the president, was not liable to stockholders for money lost by the bank through wrongful loans by the president in his own interest, merely because of inattention and failure to supervise loans. Duties of a bank director vary according to circumstances, among which are nonresidence. See criticism in 12 Illinois Law Rev. 356; *Bowerman v. Hamner*, 250 U. S. 504, 63 L. Ed. 1113, 39 Sup. Ct. 549, note 8, *supra*.

¹¹ *Marshall v. Farmers' & Mechanics' Sav. Bank of Alexandria*,

85 Va. 676, 8 S. E. 586, 2 L. R. A. 534, 17 Am. St. Rep. 84.

¹² 263 Pa. 314, 106 Atl. 574; *E. L. Moore & Co. v. Murchison*, 226 Fed. 679 (directors cannot escape liability when they know or ought to have known that the dividends they declare have not been earned); *Leeds Estate Bldg. & Inv. Co. v. Shepherd*, L. R. [1887] 36 Ch. Div. 787, 804; *Appleton v. American Malting Co.*, 65 N. J. Eq. 375, 54 Atl. 454; *Frederick v. McRae*, 157 Minn. 366, 196 N. W. 270; 10 Virginia Law Rev. 560 (liability of bank directors to depositors for dividends wrongfully paid); *Cornell v. Seddinger*, 237 Pa. 389, 85 Atl. 446 (directors held responsible for dividends paid out of capital, even though action was based on a treasurer's report showing earnings,

§ 116. Liability for acts or neglect of other officers or employees.

To render directors or other officers of a corporation liable to it for the fraudulent or wrongful acts of other officers, they must have participated therein, or else they must be chargeable with negligence. The loss must be the result of a culpable failure on their part to discharge a duty which they were under to the company with respect to the selection or supervision of the guilty officers. The directors of a corporation, it was said in the Supreme Court of the United States, "are not insurers of the fidelity of the agents whom they have appointed, who are not their agents but the agents of the corporation; and they cannot be held responsible for losses resulting from the wrongful acts or omissions of other directors or agents, unless the loss is a consequence of their own neglect of duty, either for failure to supervise the business with attention or in neglecting to use proper care in the appointment of agents."¹³

In *Briggs v. Spaulding*¹⁴ the receiver of a national bank sued directors for losses due to their negligence. The president, Lee, was allowed practically absolute control without any close supervision and in a few months wrecked the bank by loans to himself and to his relatives upon unsecured notes or worthless collateral. No directors' meeting was held between October 3, 1881, and April 14, 1882, when the principal losses occurred; and no examining committee was appointed as provided in the by-laws. By a vote of five to four, the Supreme Court held that the various directors were excused from liability on one ground or another. The majority recognized that the directors' right to intrust the business to officers does not absolve them from the duty of reasonable supervision, but in this case they found the directors excusable for not preventing the losses. In a vigorous dissenting opinion Justice Harlan declares the case one of supine, continuous negligence upon the part of Coit, Johnson and Spaulding in the discharge of their duties, and that the losses could have been avoided by the exercise of reasonable diligence. The difference of opinion between the majority and the dissenting minority seems to center not so much

whereas in fact no earnings had been made. Directors are required to make reasonable investigations).

¹³ *Briggs v. Spaulding*, 141 U. S. 132, 35 L. Ed. 662, 11 Sup. Ct. 924;

Swentzel v. Penn Bank, 147 Pa. St. 140, 23 Atl. 405, 415, 15 L. R. A. 305, 30 Am. St. Rep. 718.

¹⁴ 141 U. S. 132, 35 L. Ed. 662, 11 Sup. Ct. 924.

in the legal standard of care to be required as in the vigor of its application to the facts of the case.

Since this is perhaps the leading case on this important subject it seems worth while to quote a more detailed statement of the facts bearing on the excuses allowed the directors for their neglect of duty from the opinion of Judge Hughes in *Robinson v. Hall*,¹⁵ commenting on *Briggs v. Spaulding*: "It was one of the allegations of the bill that the bank was entirely solvent and in sound condition on October 3, 1881. It failed on April 14, 1882. Other facts in the case were as follows: On January 10, 1882, a board of directors was elected, composed of Spaulding, Johnson, Francis Coit, Lee, and Vought; Spaulding and Johnson for the first time. Lee was elected president, and thereupon ceased to be cashier, an office he had held for many years. The cause of the bank's suspension, April 14, was recklessness of management by Lee while cashier, and after he became president. The suit was against Lee, Francis Coit, Spaulding, Johnson, Cushing, the executrix of Vought, and the administrators of Charles Coit. The last named had been president and director for several years until his death, in December, 1881. Except this Charles Coit and Cushing, the men sued were those who had been elected directors on January 10, 1882. Two of the defendants—Spaulding and Johnson—were elected then for the first time. The bank had lost its capital of \$250,000 and also a surplus of \$74,000 and had incurred liabilities in excess of assets to the amount of \$535,000. All this had occurred between October 3, 1881, and April 14, 1882, when the bank suspended; all directly through the wrongful conduct of Lee, and indirectly, as charged, through the negligence of the directors. The bill was taken for confessed as to Lee and as to the executrix of Vought. As to Cushing, it was proved that he had resigned as director, and sold all his stock in the bank on September 24, 1881, and was never a qualified director afterwards, or capable of negligence. Charles Coit had obtained leave of absence on October 3, 1881, on account of severe illness of which he died December 11, 1881. Johnson was newly elected in January, 1882; very soon after which time his wife became severely ill, and he himself, in consequence, fell into such mental and physical infirmity as to be incapacitated for business. Spaulding was 72 years of age, had retired from business, was elected for the first time on January 10, 1882, was wholly unacquainted with the business of

the bank, and was not expected, when elected, to give close attention to its affairs. . . . He and Johnson had been directors for the period of only three months; and in regard to the mental and physical condition of Johnson, and the age and other circumstances of Spaulding, it was a question whether they could reasonably be expected to have familiarized themselves with the affairs of the bank within that time. As to Francis Coit, he had been elected to replace another director on May 20, 1881, when in very feeble health, and unable to transact any business. The Supreme Court decided that Cushing, the two Coits, Spaulding, and Johnson could not reasonably be held liable in their personal estates for the losses the bank sustained during their tenures of office as directors. To this decision of the Supreme Court exonerating Cushing, Coit's estate, Spaulding, Johnson, and Francis Coit there was a strong and imposing dissent. The dissenting Justices were Harlan, Gray, Brewer, and Brown, whose objections are stated in an extended and very cogent opinion written by Mr. Justice Harlan. Such a dissent admonishes the federal courts which, in the course of duty, have to deal with this question, very strongly against exceeding the limits of leniency exhibited by the Supreme Court towards the directors with whom it dealt in the case of *Briggs v. Spaulding*." In *Robinson v. Hall*¹⁶ it was found that the defendant directors were not prevented by any special circumstances, as in *Briggs v. Spaulding* from giving close attention to the affairs of the bank.

In *Dovey v. Cory*,¹⁷ the liquidator of a bank sued a director for £37,000 for breach of duty in not ascertaining the true condition of the bank, and assenting to the payment of dividends out of capital and to advances to directors without security. He relied in good faith on fraudulent balance sheets, and on statements of the chairman and general manager of the bank. It was held that he was not negligent in his duties as director in not detecting the fraudulent acts of the general manager and other officers. It cannot be expected that a director should attend to the details of management and watch inferior officers, auditors or the managing director.

The directors, however, are liable for the fraud and other wrongful acts of other officers and agents if they have been guilty of culpable negligence in their selection or supervision. Bank di-

¹⁶ 63 Fed. 222.

¹⁷ L. R. App. Cas. 477. Compare

In re Equitable Fire Ins. Co. [1925]

Ch. 407, 427.

rectors are liable for the resulting losses from retaining a dishonest cashier who was known to be loaning money contrary to the by-laws and making improper entries, especially after warning by the banking commissioner.¹⁸ In *Campbell v. Watson*,¹⁹ a bank receiver sued directors for losses caused by their negligence and recovered against all of them. The bank's charter provided that the directors should publish quarterly statements showing the actual condition of the bank. A by-law required a committee of three members to examine into the affairs of the bank every three months. The cashier was guilty of peculations continued for several years without detection. The directors trusted the correctness of the accounts with a correspondent bank entirely to the cashier. A comparison of the balance sheet or transcript of account of the correspondent bank with the books of the insolvent bank would have revealed the defalcations. It was held that the evidence was sufficient to show that the perpetration of the fraud was the consequence of the director's neglect. Ignorance of by-law requiring examinations of the books is no excuse. It is interesting to observe that the thefts could not have been discovered by an examination of the books of the insolvent bank nor by a count of the cash, but only by a comparison of the transcript of accounts rendered by the correspondent bank with the bank's books.

Other officers may be under similar responsibility for fraud of subordinates. Thus, where it is the duty of the president of a corporation to supervise its affairs, and take and keep bonds from subordinate officers, and he negligently fails to take the required bond from an officer who is intrusted with funds, and who becomes a defaulter, he is liable to the corporation for the loss.²⁰ In *Bates v. Dresser*,²¹ a bookkeeper of a national bank on a salary of \$12 per week defrauded it during a series of years of an amount aggregating more than its capital and more than the normal average of deposits. This was accomplished in a novel and ingenious way by the falsification of the deposit ledger, by false charges against deposits, diminishing the apparent liability to depositors. It was held that the directors, serving gratuitously, were not negligent in accepting the cashier's statements of liabilities and were not

¹⁸ *Roseville Trust Co. v. Nott*, — N. J. Eq. —, 107 Atl. 462.

¹⁹ 62 N. J. Eq. 396, 50 Atl. 120.

²⁰ *Pontchartrain R. Co. v. Paulding*, 11 La. 41, 30 Am. Dec. 708.

²¹ 251 U. S. 524, 64 L. Ed. 388,

40 Sup. Ct. 247; s. c., 250 Fed. 525. There was a by-law nearly obsolete calling for examinations by a committee semi-annually. See 15 Illinois Law Rev. 279.

bound to inspect the depositors' ledger or call in the pass books and compare them with it. The fraud could have been discovered by the cashier if he examined checks as they came from the clearing house, or if he had compared the deposit ledger with the depositors' pass books. But he negligently over-trusted the bookkeeper. The president who had received certain warnings that the bookkeeper was living fast and dealing in stocks was guilty of negligence in failing to make an examination, especially as he was in control of affairs, with immediate access to the depositors' ledger.

II. PERSONAL LIABILITY.

§ 117. *Ultra vires* and excess of authority.

Directors, officers and managers when acting for the corporation are bound by the restrictions imposed by the charter and by-laws of the company. For acts in excess of their powers they are liable for damages caused to the company. A restriction placed upon the corporation itself necessarily limits the power of all its officers and agents, and directors are liable for unauthorized acts as well as for failure to exercise proper care and diligence in the discharge of the duties of their office, when such acts are productive of loss and damage. The directors of a bank or other corporation are bound to act within the scope of the corporation's charter and by-laws.²²

In a New York case, it is said: "A director is only liable to the corporation or its stockholders for his own acts or omissions, and to render him liable for *ultra vires* acts of the corporation it must be shown and found that he voted therefor, participated therein, connived thereat, or negligently omitted to perform his duty."²³ It is a more or less doubtful question how far honest mistake of officers as to their powers and absence of negligence may be set up as an excuse, and whether they are not absolutely liable whether they act with due care and in good faith or not.

²² Cockrill v. Cooper, 86 Fed. 7; Hill v. Murphy, 212 Mass. 1, 98 N. E. 781, 40 L. R. A. (N. S.) 1102, Ann. Cas. 1913 C 374; Fergus Falls Woolen Mills v. Boyum, 136 Minn. 411, 162 N. W. 516, L. R. A. 1918 A 919. The recognition by the stockholders of the claims of creditors created by the manager of the corporation in excess of the debt limit did not waive the right to hold the

manager liable for the damages resulting from his *ultra vires* acts in contracting such claims. Horn Silver Min. Co. v. Ryan, 42 Min. 196, 44 N. W. 56; North Hudson Mut. Building & Loan Ass'n v. Childs, 82 Wis. 460, 52 N. W. 600, 33 Am. St. Rep. 57.

²³ Holmes v. Crane, 191 N. Y. App. Div. 820, 182 N. Y. Supp. 270, aff'd 232 N. Y. 571, 134 N. E. 576.

In *Hodges v. New England Screw Co.*,²⁴ a suit was brought against directors on the ground that purchase of stock in another corporation was *ultra vires* and that the directors were liable for the consequences. The purchase was made in good faith and in the exercise of good business judgment, because by the transaction the directors disposed to advantage of an unprofitable business. It was held that the directors are not personally liable for a violation of the charter, where such violation resulted from an innocent mistake as to the extent of their powers and there was no lack of ordinary care or prudence.

In *Gilbert v. Finch*,²⁵ a receiver sued the directors of an insurance company who paid \$35,000 to the stockholders of the M Insurance Company which was then insolvent, in order to gain control, so that policyholders in the insolvent company could be offered policies in the solvent company and the purchasing company would thus get the premiums. It was held that as the insolvent company had no assets or good will, this was an *ultra vires* act, and a waste of the funds of the purchasing corporation to give them away in this fashion in the hope of getting business thereby. They must make good the loss which was sustained, regardless of their good motives.

The question of criminal liability of officers for the *ultra vires* diversion of corporate funds is determined by different standards as to culpability than the question of civil liability.²⁶ A stockholder cannot have redress for *ultra vires* acts when with full knowledge of the facts he has assented to them, though under protest, and has accepted the benefit of them, nor can a corporation sue its directors for the consequences of such acts if all the stockholders have acquiesced in them.²⁷

²⁴ 1 R. I. 312, 53 Am. Dec. 624. See also, *Williams v. McDonald*, 37 N. J. Eq. 409, 413; *Williams v. McKay*, 46 N. J. Eq. 25, 18 Atl. 824; *In re Liverpool Household Stores Ass'n*, 62 L. T. R. 873, 875.

²⁵ 173 N. Y. 455, 66 N. E. 133, 61 L. R. A. 807, 93 Am. St. Rep. 623. This case can be placed on the ground of negligence.

²⁶ *People ex rel. Perkins v. Moss*, 187 N. Y. 410, 80 N. E. 383, 11 L. R. A. (N. S.) 528, 10 Ann. Cas. 309. Contribution of \$50,000 to presidential campaign fund by president of New York Life Insurance Company was *ultra vires* as foreign to

the chartered purposes of the company, but not criminal or illegal in the sense of violating any public interest. Officers civilly liable, but not guilty of stealing. See 7 Columbia Law Rev. 387, *Larceny and the Perkins case*, by Burdick.

²⁷ The officers of a corporation may defend an action for carrying on a business not authorized by the charter, by showing the stockholders' acquiescence in or assent to the business, express or implied. *Holmes v. Willard*, 125 N. Y. 75, 25 N. E. 1083; *Holmes v. Crane*, 191 N. Y. App. Div. 820, 182 N. Y. Supp. 270. See *Wormser v. Metropolitan St. R.*

§ 118. Liability arising out of contracts.—Officers of a corporation who enter into contracts on behalf of the corporation, to the knowledge of the other party, and in such a way as to bind it, are not personally liable. But they are liable if they contract in their own name, without disclosing the fact that they are contracting on behalf of the corporation only. And they are liable either on the contract or in tort, according to the rule in the particular jurisdiction, if they undertake to contract for the corporation without authority, or for a corporation which has no existence, or in excess of the powers of the corporation, provided the other party has no knowledge of such facts, and is not chargeable with notice thereof.

Whether an agent is personally liable on a contract where he intended to bind the corporation only, depends upon general principles of the law of agency. If he contracts in the name of the corporation, or in his own name as officer or agent, with the understanding on the part of both parties that the contract is with the corporation, he is not personally liable, if the contract is within his authority, or is ratified by the corporation, or, even though it is not within his authority and is not ratified, if the other party is chargeable with knowledge of his want of authority.²⁸ If, on the other hand, an officer or agent of a corporation enters into a contract without disclosing the fact that he is acting for the corporation, or otherwise than individually, the other party may, at his election, either hold the corporation on the contract, or hold the officer personally liable, but he cannot hold both.²⁹

Excess or want of authority.—If an officer enters into a contract for and in the name of the corporation, but in excess of his authority, and the contract is not ratified by the corporation, the other party not having knowledge of his want of authority, he is personally liable,—in some jurisdictions, on the contract itself, or in an action of *assumpsit*, on the theory of an implied warranty of authority, and, in other jurisdictions, in an action on the case for false warranty of authority.³⁰

Co., 184 N. Y. 83, 76 N. E. 1036, 112 Am. St. Rep. 596, 6 Ann. Cas. 123; Towers v. African Tug Co., L. R. [1904] 1 Ch. Div. 558; 3 Minnesota Law Rev. 206.

²⁸ Ferguson v. Wilson, 2 Ch. App. 77; Ogden v. Raymond, 22 Conn. 379, 58 Am. Dec. 429; Hall v. Hun-

toon, 17 Vt. 244, 44 Am. Dec. 332; Sampson v. Fox, 109 Ala. 662, 670, 19 So. 896, 55 Am. St. Rep. 950.

²⁹ Holt v. Ross, 54 N. Y. 472, 13 Am. Rep. 615.

³⁰ Clinchfield Fuel Co. v. Hender-son Iron Works Co., 254 Fed. 411. See Loveland v. Hanson, 172 Wis.

Pretended but nonexistent corporation.—This principle also applies where a person enters into a contract in the name of a pretended corporation, or of an association which, in attempting to organize, has not so far complied with the law as to acquire a *de facto* corporate existence, or the power to commence business and enter into contracts, or in the name of a foreign corporation which has not complied with the statutes of the state prescribing conditions precedent to the right to do business therein.³¹

Ultra vires contracts.—There is some conflict whether an officer is liable where he enters into a contract for the corporation which is not binding upon it because *ultra vires*, the other party not having knowledge of this fact, nor being chargeable with knowledge. Some cases permit the outsider to hold the agent personally responsible for any loss upon an implied warranty either of his own authority or the capacity of his principal.³² But some cases hold that where a person enters into a contract with the officers of a corporation, intending a contract with the corporation, and the contract does not bind the corporation because it is not within the powers of the corporation, the person so contracting is chargeable, as well as the officers, with notice of the want of power on the part of the corporation, and in such a case he cannot hold the officers personally liable.³³

§ 119. Liability arising out of torts.—Officers of a corporation are personally liable for any tort committed by them against third persons, although they may act for the corporation, and although their act may be authorized by the corporation.

627, 179 N. W. 782; Mendelsohn v. Holton, 253 Mass. 362, 149 N. E. 38, 42 A. L. R. 1307, 1310 note.

³¹ Bartholomew v. Bentley, 15 Ohio St. 659, 45 Am. Dec. 596; Farmers' Co-op. Trust Co. v. Floyd, 47 Ohio St. 525, 26 N. E. 110, 12 L. R. A. 346, 21 Am. St. Rep. 846; Walton v. Oliver, 49 Kan. 107, 30 Pac. 172, 33 Am. St. Rep. 355; Lewis v. Tilton, 64 Iowa 220, 19 N. W. 911, 52 Am. Rep. 436; Lasher v. Stimson, 145 Pa. St. 30, 23 Atl. 552; Ryerson & Son v. Shaw, 277 Ill. 524, 115 N. E. 650. See 36 Yale Law Journal 709.

³² West London Commercial Bank, Ltd. v. Kitson, 13 Q. B. D. 360; Weeks v. Propert, L. R. 8 C. P. 427; Richardson v. Williamson, L. R. 6 Q. B. 276; Small v. Elliott, 12

S. D. 570, 82 N. W. 92, 76 Am. St. Rep. 630; Knickerbocker v. Wilcox, 83 Mich. 200, 47 N. W. 123, 21 Am. St. Rep. 595; Mandeville v. Court-right, 142 Fed. 97, 6 L. R. A. (N. S.) 1003; Raff v. Isman, 235 Pa. 347, 84 Atl. 352. See 48 Am. St. Rep. 913, 915n. Liability of an agent of a corporation for its *ultra vires* contracts. 26 Harvard Law Rev. 542.

³³ Abeles v. Cochran, 22 Kan. 405, 31 Am. Rep. 194; Eaglesfield v. Marquis of Londonderry, 4 Ch. Div. 693; Humphrey v. Jones, 71 Mo. 62; Sandford v. McArthur, 18 B. Mon. (Ky.) 411; Frost Mfg. Co. v. Foster, 76 Iowa 535, 41 N. W. 212; Thilmany v. Iowa Paper Bag Co., 108 Iowa 357, 79 N. W. 261, 75 Am. St. Rep. 259.

It is thoroughly well settled that a man is personally liable for all torts committed by him, consisting in misfeasance,—as fraud, conversion, acts done negligently, etc.,—notwithstanding he may have acted as the agent and under directions of another. And this is true to the full extent of the torts committed by the officers or agents of a corporation in the management of its affairs. The fact that the circumstances are such as to render the corporation liable is altogether immaterial. The person injured may hold either liable, and generally he may hold both as joint tortfeasors.³⁴

§ 120. Liability to creditors for misconduct in office.

Some of the courts have held that mere creditors of an insolvent bank or other corporation cannot sue, even in equity, to hold the directors or other officers liable for losses due to mere negligence, although a cause of action therefor may exist in favor of the corporation, on the ground that there is no trust relation or privity between the officers and creditors.³⁵ The weight of authority, however, is to the contrary and in favor of recovery by creditors.³⁶ Most of the courts have based the right of creditors to sue on the ground that there is a trust relation between the officers and creditors, or a *quasi* trust relation;³⁷ but there certainly is not “trust

³⁴ *Hitchcock v. American Plate Glass Co.*, 259 Fed. 948.

Participation in or authorization of the tort is essential to liability. *Sterns Lumber Co. v. J. H. Rice Co.*, 260 Fed. 434; *Ducey v. Brunell*, 250 Mass. 114, 145 N. E. 37.

An agent or officer of a corporation is not liable for nonfeasance (elevator out of repair) to anyone but his principal or employer. It is otherwise if there is participation in negligent action which constitutes something more than nonfeasance. *Tibbetts v. Wentworth*, 248 Mass. 468, 143 N. E. 349, citing *Corliss v. Keown*, 207 Mass. 152, 93 N. E. 143; *Proctor v. Dillon*, 235 Mass. 538, 129 N. E. 265.

³⁵ *Wilson v. Stevens*, 129 Ala. 630, 29 So. 678, 87 Am. St. Rep. 86; *Union Nat. Bank v. Hill*, 148 Mo. 380, 49 S. W. 1012, 71 Am. St. Rep. 615. See also, *Deaderick v. Bank of Commerce*, 100 Tenn. 457, 45 S. W. 786; *Landis v. Sea Isle City Hotel Co.*, 53 N. J. Eq. 654, 33 Atl. 964; *Frost Mfg. Co. v. Foster*, 76 Iowa 535, 41 N. W. 212; *United States Fidelity*

& Guaranty Co. v. Corning State Sav. Bank, 154 Iowa 588, 134 N. W. 857, 45 L. R. A. (N. S.) 421; *Allen v. Cochran*, 160 La. 489, 107 So. 292; *Fletcher, Corporations*, secs. 2574, 2575; 7 *Corpus Juris*, p. 565.

³⁶ *Nix v. Miller*, 26 Colo. 203, 57 Pac. 1084; *Swentzel v. Penn Bank*, 147 Pa. St. 140, 23 Atl. 405, 415, 15 L. R. A. 305, 30 Am. St. Rep. 718; *Marshall v. Farmers' & Mechanics' Sav. Bank of Alexandria*, 85 Va. 676, 8 S. E. 586, 2 L. R. A. 534, 17 Am. St. Rep. 84; *Delano v. Case*, 121 Ill. 247, 12 N. E. 676, 2 Am. St. Rep. 81; *Savings Bank of Louisville's Assignee v. Caperton*, 87 Ky. 306, 8 S. W. 885, 12 Am. St. Rep. 488; *Gores v. Day*, 99 Wis. 276, 74 N. W. 787; *McCollum v. Dollar*, — Tex. Comm. App. —, 213 S. W. 259.

³⁷ See the cases in the note preceding. See also, *Williams v. McKay*, 40 N. J. Eq. 189, 53 Am. Rep. 775; *Campbell v. Watson*, 62 N. J. Eq. 396, 50 Atl. 120; *Segal v. Davis*, 166 Minn. 265, 207 N. W. 620; *In re Brockway Mfg. Co.*, 89 Me. 121, 35 Atl. 1012, 56 Am. St. Rep. 401.

relation," in the proper sense of the term.³⁸ The proper view is that the officers become liable to the corporation for the loss sustained by it, and that this liability is a part of its assets, which may be enforced in equity, as other equitable assets may be collected, for the purpose of satisfying the claims of creditors.

All of the courts no doubt agree that suit to hold the directors or other officers liable under the circumstances above stated may be maintained, by reason of their liability to the corporation, by a receiver of the corporation, who represents the corporation as well as the creditors, or a trustee in bankruptcy or other official liquidator.³⁹

As a general rule, the creditors of a corporation cannot maintain actions at law against the directors or other officers to recover their debts, or to recover damages for conversion of its assets or losses by reason of misapplication thereof or of negligence, for the injury is to the corporation.⁴⁰ The courts, however, are more inclined to assist depositors in savings banks than creditors of the other corporations.

It has been held, that a depositor in a bank may maintain an action in tort against the directors or other officers for loss of his deposit by reason of their fraud or negligence in the management of the bank, on the ground of fraud and deceit in holding out the bank as solvent, or allowing it to be held out as solvent, and thereby inducing the public to make deposits, or to allow deposits to remain.⁴¹ So also a suit in equity may be brought by creditors and

³⁸ See ante, § 114; *Boyd v. Mutual Fire Ins. Ass'n*, 116 Wis. 155, 90 N. W. 1086, 94 N. W. 171, 61 L. R. A. 918, 96 Am. St. Rep. 948, 3 Columbia Law Rev. 487; *Killen v. Barnes*, 106 Wis. 546, 82 N. W. 536.

³⁹ *Douglass v. Dawson*, 190 N. C. 458, 130 S. E. 195, 199. Damages resulting from breach of official duty whereby the bank becomes insolvent and thus unable to pay creditors or depositors are an asset of the bank and should be recovered by the receiver. See 14a C. J. 155. In re National Funds Assur. Co., 10 Ch. Div. 118; *Mason v. Henry*, 152 N. Y. 529, 46 N. E. 837; *Williams v. McKay*, 40 N. J. Eq. 189, 53 Am. Rep. 775; *Ellis v. Ward*, 137 Ill. 509, 25 N. E. 530; In re Brockway Mfg. Co., 89 Me. 121, 35 Atl. 1012, 56 Am. St. Rep. 401; *Boyd v. Mutual Fire Ass'n*, 116 Wis. 155, 94

N. W. 171, 61 L. R. A. 918, 96 Am. St. Rep. 948.

⁴⁰ *Fusz v. Spaunhorst*, 67 Mo. 264; *Branch v. Roberts*, 50 Barb. (N. Y.) 435; *Winter v. Baker*, 50 Barb. (N. Y.) 432, 34 How. Pr. 183; *Zinn v. Mendel*, 9 W. Va. 580. See also, *Frost Mfg. Co. v. Foster*, 76 Iowa 535, 41 N. W. 212; *Myer v. Dupont*, 79 Ky. 416; *Smith v. Poor*, 40 Me. 415, 63 Am. Dec. 672. See *Young v. Haviland*, 215 Mass. 120, 102 N. E. 338. Compare, however, the cases cited in the note following.

⁴¹ *Tate v. Bates*, 118 N. C. 287, 24 S. E. 482, 54 Am. St. Rep. 719; *Solomon v. Bates*, 118 N. C. 311, 24 S. E. 478, 54 Am. St. Rep. 725; *Caldwell v. Bates*, 118 N. C. 323, 24 S. E. 481. And see *Delano v. Case*, 121 Ill. 247, 12 N. E. 676, 2 Am. St. Rep. 81; *Seale v. Baker*, 70 Tex. 283, 7 S. W. 742, 8 Am. St. Rep. 592.

stockholders against directors for loss sustained through their neglect to supervise the acts of its officers, where the receiver, though requested, has failed and refused to sue. Such suit is brought on behalf of all depositors and stockholders.⁴² Of course it is well settled that the directors of a corporation, whether it be a bank or a corporation of some other kind, are liable in an action of deceit for false representations as to its financial condition, which they know or ought to know to be false, and which cause persons to deal with the corporation to their damage.⁴³

§ 121. Liability of officers under statutory provisions.

In many jurisdictions, for the better protection of the creditors of corporations, or of depositors in banks, the legislatures have enacted statutes making the directors, trustees, or other officers personally liable for corporate debts if they shall neglect to perform certain duties imposed upon them, or if they shall do certain acts which are prohibited. These statutes vary in the different states. Thus in some states the statute makes the directors or other officers of a corporation liable for corporate debts if they shall intentionally neglect or refuse to comply with the provisions of the act under which the corporation is formed, and to perform the duties therein required of them, or if they shall order or assent to the violation of the act by the corporation, and it shall become insolvent, etc.;⁴⁴ or if they shall wrongfully pay dividends when there are no surplus profits available for the purpose, and thereby impair the capital stock, or render the corporation insolvent;⁴⁵ or if they shall contract debts on behalf of the corporation, or allow

Compare *Utley v. Hill*, 155 Mo. 232, 55 S. W. 1091, 49 L. R. A. 323, 78 Am. St. Rep. 569, holding that the directors must have actual knowledge of the insolvency of the bank.

⁴² *Ellis v. H. P. Gates Mercantile Co.*, 103 Miss. 560, 60 So. 649, 43 L. R. A. (N. S.) 982, Ann. Cas. 1915 B 526.

⁴³ *Coughlin v. State Bank of Portland*, 117 Ore. 83, 243 Pac. 78, 83; *Seale v. Baker*, 70 Tex. 283, 8 Am. St. Rep. 592; *Chapple v. Jacobson*, 234 Mich. 558, 208 N. W. 754 (declaration of unearned dividend by directors made them liable to subsequent purchaser of bonds for damages suffered by its subsequent insolvency).

⁴⁴ See *Patterson v. Stewart*, 41 Minn. 84, 42 N. W. 926, 4 L. R. A. 745, 16 Am. St. Rep. 671; *Loverin*

v. McLaughlin, 161 Ill. 417, 44 N. E. 99; *Clow v. Brown*, 150 Ind. 185, 49 N. E. 1057; *Fletcher, Corporations*, sec. 2620.

⁴⁵ *Southern California Home Builders v. Young*, 45 Cal. App. 679, 691, 188 Pac. 586, 592. See *Rorke v. Thomas*, 56 N. Y. 559; *Dykman v. Keeney*, 160 N. Y. 677, 54 N. E. 1090; *Williams v. Boice*, 38 N. J. Eq. 364; *Whittaker v. Amwell Nat. Bank*, 52 N. J. Eq. 400, 29 Atl. 203. See also, note, 35 Yale Law Journal 870, the statutory responsibility of directors for payment of dividends out of capital: "Whether the responsibility thus imposed is absolute, irrespective of fault, or whether it is dependent on bad faith or negligence is a question on which most of the statutes are silent."

it to contract debts, before the whole capital stock of the corporation or certain percentage thereof is subscribed, or before it is paid in, and a certificate to such effect filed;⁴⁶ or if they shall contract debts on behalf of the corporation, or assent to the contracting of debts, in excess of the capital stock, or the capital stock paid in, or some other prescribed limitation.⁴⁷ The remedy under such statutes is generally held to be in equity rather than at law, to be enforced for the benefit of all the creditors rather than by a single creditor.^{47a}

§ 122. Nature of the statutory liability of officers; construction; repeal of statutes.

Statutes imposing liability for corporate debts upon the directors or other officers of a corporation for failure to file or publish a report of the company's condition, or neglecting to do other acts required of them by law, or for wrongfully contracting debts in violation of prescribed limitations, or doing other acts prohibited by law, are not penal statutes, in the strict and proper sense, like statutes imposing punishment for offenses against the state, but are remedial as respects the creditors.⁴⁸ They impose upon the officers, however, burdensome liabilities, not by reason of any agreement or contract on their part, but as a penalty for their neglect or misconduct, and in this sense they are penal in their nature, as respects the officers, and not contractual, and, as we shall see, they

⁴⁶ See *Edwards v. Armour Packing Co.*, 190 Ill. 467, 60 N. E. 807; *Kent v. Clark*, 181 Ill. 237; *Clow v. Brown*, 150 Ind. 185, 48 N. E. 1034, 49 N. E. 1057; *Hequembourg v. Edwards*, 155 Mo. 514, 56 S. W. 490; *Weston v. Dahl*, 162 Wis. 32, 155 N. W. 949.

⁴⁷ *Hornor v. Henning*, 93 U. S. 228, 23 L. Ed. 879; *Moore v. Lent*, 81 Cal. 502, 22 Pac. 875; *Hart-Parr Co. v. Pratt*, 272 Fed. 471; *United States Farm Land Co. v. Bennett*, 55 Cal. App. 299, 203 Pac. 795; *Woolverton v. Taylor*, 132 Ill. 197, 23 N. E. 1007, 22 Am. St. Rep. 521; *Thacher v. King*, 156 Mass. 490, 31 N. E. 648; *National Bank of Auburn v. Dillingham*, 147 N. Y. 603, 42 N. E. 338, 49 Am. St. Rep. 692.

^{47a} *Platner v. Hughes*, 200 Iowa 1363, 206 N. W. 268, 43 A. L. R. 1141, 1147 note (right of individual creditor to enforce for his own benefit personal liability of directors or

officers of corporation for incurring excessive debts. The weight of authority is "that the liability thus created is for the benefit of all the creditors, or at least for all whose claims go to make up, the excess, and that it cannot be enforced by a single creditor suing on his claim, but only in a suit on behalf of all"); *In re La Jolla Lumber & Mill Co.*, 243 Fed. 1004, 1006 (liability of directors under sec. 309, Cal. Civ. Code, a trust fund for the benefit of all creditors ratably).

⁴⁸ *Huntington v. Attrill*, [1893] App. Cas. 150; *Huntington v. Attrill*, 146 U. S. 657, 36 L. Ed. 1123, 13 Sup. Ct. 224; *United States Smelting Co. v. Hofkin*, 245 Fed. 896; *Great Western Machinery Co. v. Smith*, 87 Kan. 331, 124 Pac. 414, 41 L. R. A. (N. S.) 379, Ann. Cas. 1913 E 243; 6 Minnesota Law Rev. 300 note,

are governed by some of the principles which apply to penal statutes in the proper sense.⁴⁹ Of course, it is possible for a statute to impose upon the directors and other officers of a corporation a contractual liability, or a *quasi* contractual liability, for corporate debts, just as it may impose such a liability upon stockholders.⁵⁰ In such a case, by becoming officers and contracting debts, they agree to assume the liability imposed by the statute, and the liability is therefore contractual in its nature. Such a liability is imposed by a charter of a bank declaring that, on default by the bank, the president and directors shall be individually, jointly and severally, liable for the payment of any bills or notes which they may issue or circulate. In such a case the liability is not imposed upon them as a penalty for any neglect or misconduct.⁵¹ And it has been held that a statute making the directors of a corporation liable for debts contracted in excess of its capital stock, but not prohibiting them from contracting such debts, does not impose a penal liability, but imposes a *quasi* contractual liability analogous to the liability of a surety.⁵²

Strict construction of statutes.—When the statute imposes a liability in the nature of a penalty, it is penal in such a sense as to be subject to the general rule that penal statutes are to be strictly construed; and an officer cannot be held liable unless the case comes clearly and strictly within the terms of the statute.⁵³

Repeal of statutes.—Such statutes are also penal in such a sense that they may be repealed at any time, even after an ac-

⁴⁹ *Providence Steam-Engine Co. v. Hubbard*, 101 U. S. 188, 25 L. Ed. 786; *Loveland v. Garner*, 71 Cal. 541, 12 Pac. 616; *Moss v. Smith*, 171 Cal. 777, 155 Pac. 90; *Talcott Land Co. v. Hershiser*, 184 Cal. 553, 195 Pac. 653; *Adler v. Baker-Dodge Theatre Co.*, 190 Iowa 970, 181 N. W. 254; *Mitchell v. Hotchkiss*, 48 Conn. 9, 40 Am. Rep. 146; *Attrill v. Huntington*, 70 Md. 191, 14 Am. St. Rep. 344; *Gardner v. Rumsey*, 81 Okla. 20, 196 Pac. 941, 25 A. L. R. 1411, 1428 note (statute relating to liability of officers or directors is penal as to extra-territorial enforcement).

⁵⁰ *Parsons v. Rinard Grain Co.*, 186 Iowa 1017, 173 N. W. 276.

⁵¹ See *Ex parte Van Riper*, 20 Wend. (N. Y.) 614, as explained and distinguished in *Derrickson v. Smith*, 27 N. J. Law 166.

⁵² *Woolverton v. Taylor*, 132 Ill. 197, 23 N. E. 1007, 22 Am. St. Rep. 521; *Farr v. Briggs' Estate*, 72 Vt. 225, 47 Atl. 793, 82 Am. St. Rep. 930. See also, *National Bank of Auburn v. Dillingham*, 147 N. Y. 603, 42 N. E. 338, 49 Am. St. Rep. 692; *Hornor v. Henning*, 93 U. S. 228, 23 L. Ed. 879.

⁵³ *Providence Steam Engine Co. v. Hubbard*, 101 U. S. 188, 25 L. Ed. 786; *Park Bank of New York v. Remsen*, 158 U. S. 337, 39 L. Ed. 1008, 15 Sup. Ct. 891; *Garrison v. Howe*, 17 N. Y. 458; *Bruce v. Platt*, 80 N. Y. 379; *Loveland v. Garner*, 71 Cal. 541, 12 Pac. 616. See the dictum of Mr. Justice Gray in *Huntington v. Attrill*, 146 U. S. 657, 36 L. Ed. 1123, 13 Sup. Ct. 224; *Butler v. Peters*, 62 Mont. 381, 205 Pac. 247, 26 A. L. R. 560.

tion has been commenced by a creditor, without violating constitutional prohibitions against laws impairing the obligation of contracts or interfering with vested rights. A creditor has no vested right under such a statute against an officer until he has recovered a judgment against him.⁵⁴

The Supreme Court of the United States has settled the law in this country in so far as the right of a creditor who has recovered a judgment to enforce the same in another state is concerned. It has held that a judgment recovered by a creditor against a director, under such a statute, in the state in which the corporation was created, is not based upon a penal statute in the sense of the rule of international law under which penal statutes are not enforced in other states, and that for the courts of other states to refuse to enforce the judgment on this ground is to deny to the judgment the full faith, credit, and effect to which it is entitled under the Constitution and laws of the United States.⁵⁵

III. PERSONAL INTEREST IN TRANSACTIONS.

§ 122a. In general.—Since the directors and other officers of a corporation occupy a fiduciary relation towards the corporation, they cannot, either directly or indirectly, in their dealings on behalf of the corporation, or in any transaction in which it is their duty to guard the interests of the corporation, make any secret profit, or acquire any personal advantage, out of their office.

Officers of a corporation cannot contract with it, or represent another party in contracting with it except under such restrictions as apply to agents, trustees, promoters and other fiduciaries.

Officers of a corporation, at least when they have no interest to protect, cannot purchase the property of the corporation at a sale on execution or for taxes, or on foreclosure of a mortgage, etc., without the consent of the corporation, and thus make a profit at its expense; but they may purchase in order to protect private interests, if they do so openly and in good faith, and if they do not at the time represent the corporation in the matter.

As was stated in a former section, it is sometimes said that the directors and other officers of a corporation are trustees for the cor-

⁵⁴Gregory v. German Bank of Denver, 3 Colo. 332, 25 Am. Rep. 760; Knox v. Baldwin, 80 N. Y. 610; Victory Webb Printing & Folding Machine Mfg. Co. v. Beecher, 97 N. Y. 651. See Moss v. Smith, 171 Cal. 777, 155 Pac. 90; Bernheimer v. Con-

verse, 206 U. S. 516, 51 L. Ed. 1163, 27 Sup. Ct. 755.

⁵⁵Huntington v. Attrill, 146 U. S. 657, 36 L. Ed. 1123, 13 Sup. Ct. 224, rev'g Attrill v. Huntington, 70 Md. 191, 16 Atl. 651, 2 L. R. A. 779, 14 Am. St. Rep. 344. See Gardner v.

poration, but, strictly speaking, this is not true. The relation is that of principal and agent, and is governed by substantially the same rules as govern a similar relation between natural persons.⁵⁶ It is clear, however, that, as agents intrusted with the management of the corporation, they occupy a fiduciary relation, and it is well settled, therefore, that they cannot, either directly or indirectly, in their dealings on behalf of the corporation with others, or in any other transaction in which they are under a duty to guard the interests of the corporation, make any secret profit, or acquire any other personal benefit or advantage, not also enjoyed by the other stockholders, and, if they do so, they may be compelled to account therefor to the corporation in an appropriate action.⁵⁷ In such a case, the corporation or its receiver may sue to recover any secret profit made.⁵⁸

In *Archer's Case*,⁵⁹ the liquidator of the North Australian Company sued Archer, a director, asking that he be ordered to pay a certain sum received from the promoter of the company. Archer was induced to become a director on the agreement by the promoter to purchase his shares at any time for the price Archer paid. Under this contract of indemnity against loss he purchased the fifty qualification shares. After acting as director for some time Archer resigned. The value of the shares had fallen to nothing,

Rumsey, 81 Okla. 20, 196 Pac. 941, 25 A. L. R. 1411, 1428 note.

⁵⁶ Ante, § 114; Dawson v. National Life Ins. Co., 176 Iowa 362, 157 N. W. 929, L. R. A. 1916 E 878; Winston v. Gordon, 115 Va. 899, 80 S. E. 756; 3 Pomeroy, Equity Juris. (4th Ed.), § 1089; Lynch, 3 California Law Rev. 21, 22. See also, 7 Ruling Case Law, § 441; 14a Corpus Juris 99; 3 Cook, Corporations (8th Ed.), § 648.

⁵⁷ Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159; Chicago Hansom Cab Co. v. Yerkes, 141 Ill. 320, 30 N. E. 667, 33 Am. St. Rep. 315; Hoffman Steam Coal Co. v. Cumberland Coal & Iron Co., 16 Md. 456, 77 Am. Dec. 311; McClure v. Law, 161 N. Y. 78, 55 N. E. 388, 76 Am. St. Rep. 262, rev'g 20 N. Y. App. Div. 459, 4 N. Y. Supp. 84; Glen v. Kittanning Brewing Co., 259 Pa. 510 (see 69In), 103 Atl. 340, L. R. A. 1918 D 738, Ann. Cas. 1918 D 769; Gilmore v. W. J. Gilmore Drug Co., 279 Pa. 193, 123 Atl. 730.

⁵⁸ Yeiser v. United States Board &

Paper Co., 107 Fed. 340, 348, 52 L. R. A. 724.

Even though the property was worth what the company paid for it, and was adapted to the company's needs, the promoters and directors will not be permitted to retain a secret profit on the sale of property to the corporation. Rutland Elec. Light Co. v. Bates, 68 Vt. 579, 35 Atl. 480, 54 Am. St. Rep. 904; McClure v. Law, 161 N. Y. 78, 55 N. E. 388, 76 Am. St. Rep. 262; Bird Coal & Iron Co. v. Humes, 157 Pa. St. 278, 27 Atl. 750, 37 Am. St. Rep. 727; Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159; Glenn v. Kittanning Brewing Co., 259 Pa. 510, 103 Atl. 340, L. R. A. 1918 D 738, Ann. Cas. 1918 D 769 (purchase of new issue of stock).

⁵⁹ In re North Australian Territory Co. (Archer's Case), L. R. 1 Ch. Div. 322. See also, Pearson's Case, L. R. 5 Ch. Div. 336; In re London & S. W. Canal, Ltd., [1911] 1 Ch. 346.

but the promoter took them off his hands at the price agreed. Archer thus was protected against a loss he would otherwise have sustained. It was held that the fruits of the indemnity contract belonged to the corporation. The object of the charter provision that a director was to be qualified by holding and paying for fifty shares was that the director should have a stake in the concern. "The director is really a watch-dog and the watch-dog has no right, without the knowledge of his master to take a sop from a possible wolf." It is not lawful that a promoter should have a director in his pay, and the director was bound to account to the company for the money so secretly obtained by virtue of his position.

It was held in *Burland v. Earle*,⁶⁰ a case appealed to the Privy Council from Canada, where a director had violated his fiduciary duty in obtaining a secret profit on the sale of property to the corporation, that although the corporation might be entitled to rescission, it could not affirm the contract, retain the property and hold him accountable for the secret profits made by him on the transaction. The company could not insist on retaining the property while paying less than the price agreed. It would be different if the director had originally acquired the property under circumstances which raised a trust for the company.

Under the doctrine that corporate officers are liable for personal profits as fiduciaries, it has been held that a director will not be permitted to receive and retain a commission or other secret profit or advantage in the case of a sale or lease of property by or to the corporation.⁶¹ The rule is similar to that applied to promoters.⁶² An officer or director may not acquire a lease of premises which the corporation occupies as a tenant, thereby depriving the corporation of the expectancy of renewing the lease. Such expectancy is recognized by the law as a valuable asset. A lease so acquired by an officer or agent is held in trust for the corporation.⁶³ And the principle applies, of course, in a great variety of other cases,—in any case, in fact, in which an officer takes ad-

⁶⁰ L. R. [1902] App. Cas. 83; s. c., 27 Ontario App. 540. See *Cook v. Deeks*, [1916] 1 S. C. 554, 564; *Highland Park Inv. Co. v. List*, 27 Cal. App. 761, 151 Pac. 162. Cp. *Yeiser v. United States Paper Board Co.*, 107 Fed. 340, 52 L. R. A. 724.

⁶¹ *Bird Coal & Iron Co. v. Humes*, 157 Pa. St. 278, 27 Atl. 750, 37 Am. St. Rep. 727; *Butland Elec. Light*

Co. v. Bates, 68 Vt. 579, 35 Atl. 480, 54 Am. St. Rep. 904. See *Fletcher, Corporations*, sec. 2318.

⁶² Ante, § 49.

⁶³ *Pike's Peak Co. v. Pfuntner*, 158 Mich. 412, 123 N. W. 19; *McCourt v. Singers-Bigger*, 145 Fed. 103, 7 Ann. Cas. 287, 295 (note on implied trust arising from renewal of lease).

vantage of his position, or neglects his duty, in order to serve his private interests, and gain a personal profit or other advantage.⁶⁴

In a New York case⁶⁵ the defendant, president and director of The Life Union was paid \$3,000 by outside parties upon the condition that he should procure their election as directors of the corporation, and that they should be given the control and management of the corporation. He turned over the control by procuring Leby and others to be elected as directors. The action was brought to recover the \$3,000. It was held that he must be regarded as having received the money by virtue of his office and by reason of his official acts, and must account for it to the corporation, and that the fact that his act was illegal and unauthorized was no defense. "All profits made in the course of an agency belong to the principal, whether they are the fruits of the performance or of the violation of the agent's duty."

Disloyalty in acting for himself instead of for corporation.—

An officer of a corporation, whose duty it is to make a contract or acquire property on behalf of the corporation and for its benefit, cannot, instead of doing so, make the contract or acquire the property for his own benefit. If he does so, he will be held by a court of equity as trustee for the corporation.⁶⁶ It is not always easy to say whether it was his official duty in a particular case to act on behalf of the corporation or whether it was open to him to seize an opportunity on his own account.⁶⁷ It is sometimes said

⁶⁴ *Wardell v. Union Pac. R. Co.*, 103 U. S. 651, 26 L. Ed. 509; *Lazenby v. Henderson*, 241 Mass. 177, 135 N. E. 302 (a director of the T. Piano Company took advantage of the financial straits of his company to buy pianos at prices which he knew to be inadequate. He kept the majority of the board in ignorance of the terms of the contract. He was held accountable for the profits made by this abuse of his dominant position); *Gilmore v. W. J. Gilmore Drug Co.*, 279 Pa. 193, 123 Atl. 730 (treasurer of corporation bought land on his own account with money obtained from the corporation and then endeavored to foist it on the company at more than double the cost to him).

⁶⁵ *McClure v. Law*, 161 N. Y. 78, 55 N. E. 388, 76 Am. St. Rep. 262, rev'g 20 N. Y. App. Div. 459, 47 N.

Y. Supp. 84; *Smitz v. Leopold*, 51 Minn. 455, 53 N. W. 719.

⁶⁶ *Trenton Banking Co. v. McKelway*, 8 N. J. Eq. 84; *Blake v. Buffalo Creek R. Co.*, 56 N. Y. 485; *Averill v. Barber*, 53 Hun (N. Y.) 636, 6 N. Y. Supp. 80; *McClure v. Law*, 161 N. Y. 78, 55 N. E. 388, 76 Am. St. Rep. 262; *Higgins v. Lansingh*, 154 Ill. 301, 40 N. E. 362.

⁶⁷ "Men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favor business which should properly belong to the company they represent," e. g., obtaining a contract in their own names to the exclusion of the company. *Cook v. Deeks*, [1916] 1 A. C. 554, 27 Dom. Law Rep. 1.

that officers cannot buy up claims at a discount, and enforce them against the corporation for their full face value.⁶⁸ But this rule has been relaxed where the directors owe no present duty to discharge or buy the corporate securities or debts, the corporation is solvent and the claim is a liquidated amount fixed before the director purchased.⁶⁹ If, however, the claim is due at the time the director purchased, some cases hold that the director violates a duty when he purchases for himself without first offering the opportunity to his corporation.⁷⁰

In *Ft. Payne Rolling Mill v. Hill*,⁷¹ a director was employed to settle claims against his company and was to be allowed as his commission the discounts obtained. As a director he took no part in the vote by which he was employed. It was held that if the contract was a fair one it could not be avoided. The receiver of the corporation is not entitled as a matter of law to recover the sums retained by defendant by way of discount upon debts which he settled, if all the parties acted in good faith and the contract was not improvident. It is not deemed practicable absolutely to prohibit such contracts whenever there is a conflict of interest.

When is a director or officer under a duty to offer an investment to the corporation, and give it the opportunity to accept or refuse before taking it for himself? In an Arizona case it is said: "Whether in any case an officer of a corporation is in duty bound to purchase property for the corporation, or to refrain from purchasing property for himself, depends upon whether the corporation has an interest, actual or in expectancy, in the property, or whether the purchase of the property by the officer or director may hinder or defeat the plans and purposes of the corporation in the carrying on or development of the legitimate business for

⁶⁸ *Duncomb v. New York, H. & N. R. Co.*, 84 N. Y. 190, 202; *Hill v. Frazier*, 22 Pa. St. 320; *Davis v. Rock Creek Lumber, Flume & Mining Co.*, 55 Cal. 359, 36 Am. Rep. 40; *Bramblet v. Commonwealth Land & Lumber Co.*, 26 Ky. L. Rep. 1176, 83 S. W. 599, modified, 27 Ky. L. Rep. 156, 84 S. W. 545; *Perry, Trusts* (6th Ed.) sec. 428; *Cook, Corporations*, sec. 660; 10 Cyc. 798.

⁶⁹ *Seymour v. Spring Forest Cemetery Ass'n*, 144 N. Y. 333, 344, 39 N. E. 365, 26 L. R. A. 859; *Camden Safe Deposit & Trust Co. v. Citizen's Ice & Cold Storage Co.*, 69 N. J. Eq. 718, 61 Atl. 529, aff'd 71 N. J.

Eq. 221, 65 Atl. 980; *Glenwood Mfg. Co. v. Syme*, 109 Wis. 355, 85 N. W. 432; *McIntyre v. Ajax Min. Co.*, 28 Utah 162, 77 Pac. 613; *Morawetz, Corporations*, sec. 521; *Machen, Corporations*, sec. 1623.

⁷⁰ *Young v. Columbia Land & Inv. Co.*, 53 Ore. 438, 99 Pac. 936, 101 Pac. 212, 133 Am. St. Rep. 844. See 22 *Harvard Law Rev.* 593: "It was the duty of its board to take up these notes to protect the interests of the stockholders, and not in their own right against the interest of the company."

⁷¹ 174 Mass. 224, 54 N. E. 532.

which it was created.”⁷² It seems that a director is precluded from taking the assignment of any contract which would place him in such a position that he would be under temptation to use his power as director in the pursuit of his own interests to the prejudice of the corporation, and he will not be permitted to retain profits derived from such contracts. A constructive trust will be raised which will allow the fiduciary to realize from his venture no more than what will reimburse him for what he actually paid.⁷³

In *Farwell v. Pyle-National Elec. Headlight Co.*,⁷⁴ the defendant corporation obtained an exclusive license to manufacture and sell certain patented electric devices for a percentage of the gross receipts. Farwell, a director, purchased the patents and took an assignment of the contract from the patentees. He now sues the corporation for royalties on the equipment and also on repairs and replacement parts. It was held that he had no right to buy the contract for his own profit, but that the corporation was entitled to the benefit of his bargain. There was a conflict between the individual interest of Farwell with that of the corporation which it was his duty as director to protect. This case raises the question whether the fact of the corporation being in a position to take advantage of an investment that is connected with its business raises a duty in the director to offer it to the corporation before taking it for himself. This was not a liquidated demand against the corporation, but was an executory continuing contract, in which the interests of the licensor might be adverse to those of the corporation. The principle applied seems to be that a director, occupying a fiduciary position, may not purchase contracts of the corporation under which he will have the incentive together with the power to subordinate the interests of the corporation to his own.⁷⁵

⁷² Zeckendorf v. Steinfeld, 12 Ariz. 245, 262, 100 Pac. 784. See also, Trice v. Comstock, 121 Fed. 620, 61 L. R. A. 176; Lagarde v. Anniston Lime & Stone Co., 126 Ala. 496, 502, 28 So. 199. The test is, does the opportunity belong to the corporation on account of the necessities of the business in view of the obligation of the director to promote such business with loyalty and in the utmost good faith. See 4 Minn. Law Rev. 513.

⁷³ Corporation's Right to Profits

made by Directors, 4 Minn. Law Rev. 513; The Telegraph v. Lee, 125 Iowa 17, 98 N. W. 364; European & N. A. Ry. Co. v. Poor, 59 Me. 277, 59 Am. Rep. 468.

⁷⁴ 289 Ill. 157, 124 N. E. 449, 10 A. L. R. 363, noted in 4 Minnesota Law Rev. 513.

⁷⁵ See Corporation's Right to Profits made by Directors, Riley, 4 Minn. Law Rev. 513, citing Paine v. Lake Erie & L. R. Co., 31 Ind. 283; European & N. A. Ry. Co. v. Poor, 59 Me. 277; Risley v. Indianapolis, B. & W.

Rights of officers as creditors.—When a corporation is indebted to a director or other officer, the latter, as against the corporation, has the same right as a stranger to attach or levy an execution on its property, and have the same sold to satisfy the debt.⁷⁶ Whether he can thus obtain a preference over other creditors when the corporation is insolvent is a different question, and is considered in another chapter.⁷⁷

The directors and other managing officers of a corporation are under a duty to the corporation and the stockholders to prevent the property of the corporation from being sold under execution, or for taxes, or on foreclosure, etc., or, if they cannot prevent the sale, to do what they can to have it sell at the highest possible price, and, if they bring about such a sale, not under any right acquired by contract with the corporation, but in violation of their trust, and purchase the property themselves, or if, although the sale is brought about by a creditor, they purchase the same otherwise than in the most perfect good faith, all of the courts agree that the corporation is entitled to have the sale set aside, or hold them as trustees, or to compel them to account for profits made, or pay the fair value of the property.⁷⁸ In some jurisdictions the courts have gone further than this, and have held that the corporation has a right to have the sale set aside, even when there is no actual fraud or unfairness, unless there are special circumstances which render the rule inapplicable.⁷⁹

By the weight of authority, however, a purchase of corporate property by a director or other officer of a corporation at an execution or judicial sale is not voidable at the instance of the corporation or its stockholders, if he purchased fairly and openly, and if at the time he did not represent the corporation in the

R. Co., 62 N. Y. 240; *Gilman, C. & S. R. Co. v. Kelly*, 77 Ill. 426; *Barnes v. Brown*, 80 N. Y. 527 (dictum). But see note, *Right of a director to compete with the corporation*, 13 Columbia Law Rev. 431 which suggests test, whether the officers have a specific duty to transact that particular business for the corporation.

⁷⁶ *Rollins v. Shaver Wagon & Carriage Co.*, 80 Iowa 380, 45 N. W. 1037, 20 Am. St. Rep. 427; *Hoffman v. Reichert*, 147 Ill. 274, 35 N. E. 527, 37 Am. St. Rep. 219.

⁷⁷ Post, § 234; 38 Harvard Law Rev. 521.

⁷⁸ *Covington & L. R. Co. v. Bowl-*

er's Heirs, 9 Bush (Ky.) 468; *Raleigh v. Fitzpatrick*, 43 N. J. Eq. 501, 11 Atl. 1; *Hoffman v. Reichert*, 147 Ill. 274, 35 N. E. 527, 37 Am. St. Rep. 219; *J. W. Butler Paper Co. v. Robbins*, 151 Ill. 588, 38 N. E. 153; *Hoyle v. Plattsburgh & M. R. Co.*, 54 N. Y. 314, 13 Am. Rep. 595.

⁷⁹ *Hoyle v. Plattsburgh & M. R. Co.*, 54 N. Y. 314, 13 Am. Rep. 595; *Hoffman v. Reichert*, 147 Ill. 274, 35 N. E. 527, 37 Am. St. Rep. 219; *Hope v. Valley City Salt Co.*, 25 W. Va. 789; *Tobin Canning Co. v. Fraser*, 81 Tex. 407, 17 S. W. 25; *Marr v. Marr*, 73 N. J. Eq. 643, 70 Atl. 375, 133 Am. St. Rep. 742.

matter, and did not bring about the sale in violation of his duty to the corporation. And this is particularly true where the purchase was necessary in order to protect interests previously acquired by him by a valid contract with the corporation.⁸⁰

In *Twin-Lick Oil Co. of W. Va. v. Marbury*,⁸¹ the plaintiff was a corporation engaged in the production of oil from wells. Being financially embarrassed in 1867, it borrowed \$2,000 from the defendant, a director, giving a note and a deed of trust as security. The property was sold under the deed of trust, and the defendant's agent bought it in for the defendant. The bill was filed four years later to have a decree that defendant held as trustee for the corporation, and to have an accounting on the ground that he abused his trust relation to the corporation to buy in at a sacrifice. It was found that the defendant loaned the money to the corporation in good faith and took just such security as any one would have taken. On foreclosure the property was bought in by defendant at a fair and open sale, and at a reasonable price. No advantage was taken of defendant's position as a director. It was held that a director may loan money to a corporation when the money is needed and the transaction is honestly and openly entered into. So the loan being valid, the director may purchase under the trust deed given to the trustee to secure the loan, if the transaction is fair. A more strict doctrine would deprive the corporation of the aid of those most interested in giving aid judiciously, and best qualified to judge of the necessity of the aid. The transaction is subject to close scrutiny as to fairness because of the director's fiduciary position.

§ 123. **Contracts and other transactions between a corporation and its officers.**—If directors or other officers of a corporation represent it in making or authorizing a contract or other trans-

⁸⁰ *Twin-Lick Oil Co. of W. Va. v. Marbury*, 91 U. S. 587, 23 L. Ed. 328; *McKittrick v. Arkansas Cent. R. Co.*, 152 U. S. 473, 38 L. Ed. 518, 14 Sup. Ct. 661; *Saltmarsh v. Spaulding*, 147 Mass. 224, 17 N. E. 316; *Lucas v. Friant*, 111 Mich. 426, 69 N. W. 735; *New Memphis Gaslight Co. Cases*, 105 Tenn. 268, 60 S. W. 206, 80 Am. St. Rep. 880.

When a director or other officer has a valid debt against the corporation, secured by a mortgage on its property, he is entitled to foreclose the

mortgage, and may purchase at the sale. *Twin-Lick Oil Co. of W. Va. v. Marbury*, 91 U. S. 587, 23 L. Ed. 328; *Millsaps v. Chapman*, 76 Miss. 942, 26 So. 369, 71 Am. St. Rep. 547; *Saltmarsh v. Spaulding*, 147 Mass. 224, 17 N. E. 316; *Schnittger v. Old Home Consol. Min. Co.*, 144 Cal. 603, 78 Pac. 9; *Janney v. Minneapolis Industrial Exposition*, 79 Minn. 488, 82 N. W. 984, 50 L. R. A. 273.

⁸¹ 91 U. S. 587, 23 L. Ed. 328; *Wabash R. Co. v. Iowa & S. W. Ry. Co.*, 200 Iowa 384, 202 N. W. 595.

action in which they are personally interested adversely to the corporation, and their consent is necessary to bind the corporation, the transaction is generally held voidable at the option of the corporation, and without proof of fraud. Some courts apply the same rule to contracts or other transactions between a corporation and an officer, or in which an officer is otherwise personally interested, although the corporation may be represented by other officers who are disinterested, but, by the weight of authority, such a transaction is binding, if shown to be fair and free from fraud. Other courts hold that the transaction is voidable only if shown to be unfair, and fairness is a question of fact in each case.

Various rules as to effect of adverse interest.—Directors occupy a fiduciary relation to the corporation, which is similar to that of an agent to his principal or a trustee to his beneficiary. Directors cannot deal with the corporation like strangers at arm's length, under the maxim *caveat emptor*, but are bound by the strict rules of fairness and good faith which the courts have imposed on fiduciaries for the protection of those whose interest are confined to their care. Transactions in which self-interest conflicts with representative duty are frequently set aside either at the option of the beneficiary or unless their fairness is shown. Various doctrines have been laid down as to the vitiating effect of the adverse interest of one or more directors. The most extreme view is that the company is entitled to the disinterested advice of all the directors, and that no one of them can divest himself of his fiduciary duty. If any one has an adverse interest, the transaction is voidable, although fair, and the corporation is not bound to show that his influence and interest determined the action of the board. This is the application of the "prophylactic" principle in its most extreme form, and may seriously hamper honest corporate business.

A more common doctrine is that a contract with an interested director is valid if there are enough disinterested directors to make a quorum and a majority, and the contract is shown to be fair and honest. But the transaction is voidable at the option of the corporation if a majority of the representatives were adversely interested, without inquiry as to its fairness, even though fraud or breach of duty are not present. It is the policy of the law not to permit an agent to assume a position that will place too great a strain on his honesty.

A more liberal view holds that there is no presumption of the dishonesty of interested directors and that the transaction is void-

able only if shown unfair. Some courts have gone to the extent of holding that interested directors may be counted to make up a quorum and a majority to authorize a transaction with themselves if the transaction is shown to be entirely fair on the ground that this rule gives proper recognition to legitimate business needs and usages.⁸²

Strict rule, voidable at option.—The English courts and a few American jurisdictions hold that a director whose interest in a matter is adverse to the corporation which he is under duty to represent is disqualified to make a binding contract with it, and that the contract is voidable at the option of the corporation without regard to its good faith or fairness.⁸³ The rigidity of this rule is intended as a preventive or discouraging influence, vitiating without attempt at discrimination all transactions in which the officer is under temptation.

Aberdeen Ry. Co. v. Blakie Bros.,⁸⁴ was an action for specific performance of a contract by which the Railway Company had agreed to purchase from Blakie Bros. certain iron chairs. The main defense was that Thos. Blakie, the managing partner of the sellers (plaintiffs) was at the time of the contract a director and chairman of the Railway Company. The question was thus raised whether a director is precluded from dealing with a firm in which he is a partner. It was held to be a rule of general application that no fiduciary shall be allowed to enter into engagements in which he may have a personal interest conflicting with the interests of those whom he is bound by fiduciary duty to protect. "So strictly is the principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into." It was declared that whether terms of the contract were as good as could have been obtained from any other person, and whether

⁸² *Minnesota Loan & Trust Co. v. Peteler Car Co.*, 132 Minn. 277, 156 N. W. 255. See *Wyman v. Bowman*, 127 Fed. 257 (a contract between a corporation and a majority of its directors by which they loan money to it to pay its debts, valid if fair and made in good faith and no undue advantage secured); 25 *Harvard Law Rev.* 553; 21 *Harvard Law Rev.* 51; *Fletcher, Corporations*, sec. 2342.

⁸³ *Aberdeen Ry. Co. v. Blakie Bros.*, 1 Macq. H. L. Cas. 461; *Pearson v. Concord R. Corp.*, 62 N. H. 537, 13

Am. St. Rep. 590; *Munson v. Syracuse, G. & C. R. Co.*, 103 N. Y. 58, 8 N. E. 355; *North-west Transp. Co. v. Beatty* [1887] 12 App. Cas. 589, 593; *Transvaal Lands Co. v. New Belgium Land, etc., Co.*, [1914] 2 Ch. 488, 7 Brit. Rul. Cas. 63 and note.

⁸⁴ [H. L. 1854], 1 Macq. H. L. Cas. 461; *Imperial Mercantile Ass'n v. Coleman*, L. R. 6 H. L. 189; *Munson v. Syracuse, G. & C. R. Co.*, 103 N. Y. 58, 74, 8 N. E. 355. See *Machen Corps.*, sec. 1574; 1 *Virginia Law Rev.* 66.

Blakie was the sole director, or only one of many, made no difference. If one director has an adverse interest, the transaction is voidable at the option of the corporation. The corporation is entitled to the disinterested advice of all the directors.

In *Munson v. Syracuse, G. & C. R. Co.*,⁸⁵ an action was brought for specific performance of a contract to purchase rights of way and a roadbed of a former company owned by Munson and his associates. Munson was one of ten directors of the defendant company who voted in favor of the contract. It was held that the right of the company to repudiate the contract was not affected by the fact that Munson's associates, the other plaintiffs, were not themselves disabled from contracting. If one of the directors had a private interest, the corporation is not bound to show that the influence of such director determined the action of the board, or whether the transaction was unfair. The personal interest of the trustee or fiduciary invalidates all contracts made by him at the election of the party he represents. He stood in the inconsistent attitude of selling as owner and purchasing as trustee. The law cannot accurately measure the influence of a trustee with his associates, and the rigidity of the rule gives it value in weakening the temptation to unfair dealing on the part of officers and relieving the corporation of the burden of showing the transaction unfair. This is a minority rule.

Dealings where officers with adverse interest represent the corporation.—It is held in many cases that a corporation may avoid a contract without regard to its fairness if the corporation is represented by an officer who is also the opposing party in the transaction. "The board of directors as a whole is the agent of the corporation and its composite judgment is the basis of corporate action. The corporation is entitled to have this judgment formed by agents entirely free from any contaminating influence. . . . If one or more of the board of directors are so improperly influenced, the corporation is entitled to notice so that the other members of the board may form their judgment uninfluenced by the counsels of their prejudiced associates."⁸⁶ If the presence of the interested

⁸⁵ 103 N. Y. 58, 74, 8 N. E. 355.

⁸⁶ *Tri State Coal & Timber Lands Ass'n v. Nence*, 92 W. Va. 196, 114 S. E. 569; *Pacific Vinegar Works v. Smith*, 145 Cal. 352, 78 Pac. 550, 104 Am. St. Rep. 42; *California &*

A. Land Co. v. Cuddeback, 27 Cal. App. 450, 150 Pac. 379; *Crocker v. Cumberland Min. & Mill Co.*, 31 S. D. 137, 139 N. W. 783; *Citizens Development Co. v. Kypawwa Oil Co.*, 191 Ky. 183, 229 S. W. 88.

director is necessary to make a quorum, or when his vote is necessary to make a majority vote, he in part represents the corporation and the action taken is voidable.⁸⁷ But if the corporation is represented by other directors or officers, it is the majority rule that the contract or transaction is valid if fair and entered into in good faith. Thus if a corporation was represented by its president and general manager who purchased land from a director, and he did not act for the corporation in selling it the land, and the transaction was fair, the corporation could not avoid it.

If an officer of a corporation, either alone or with other officers, represents the corporation in making or authorizing a contract or other transaction, in which he is personally interested, either directly or indirectly, and his action or consent is necessary, the contract or transaction, even though it may not be void for want of two parties, comes within the well-settled rule that a trustee cannot become interested to the detriment of his *cestui que trust*, or an agent to the detriment of his principal.⁸⁸ In such a case the transaction is generally held voidable at the option of the corpo-

⁸⁷ *Hotaling v. Hotaling*, 193 Cal. 368, 224 Pac. 455 (a director being personally interested in a conveyance as grantee, adversely to the corporation was disqualified to vote the authorization of the conveyance to himself, and his presence could not be counted to make a quorum for that purpose. The resolution which purported to authorize the execution of the deed to one of the directors, at a meeting at which there were but three directors present including the grantee, was invalid); *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *De Moulin v. Magnesite Refractories Co.*, 186 Cal. 128, 199 Pac. 42; *Laybourn v. Wrape*, 72 Colo. 339, 211 Pac. 367. Director cannot be counted as part of quorum to authorize contract fixing his salary.

In *New Blue Point Min. Co. v. Weissbein*, — Cal. —, 244 Pac. 325, a trust deed was attacked as void because the resolution authorizing its execution was voted upon by two directors, who were creditors and who were needed for a quorum. It was held that by "long silence and acquiescence the corporation has lost

its right to avail itself of such objection. It may also be noted in passing that the California cases, which hold that a director cannot legally form part of a quorum which acts upon a proposition in which he is personally interested, hold that the corporate act in which said director has participated is 'voidable.' They do not use the term 'void,' and it would seem, therefore, that some affirmative act of disaffirmance is necessary on the part of the corporation to take advantage of the irregularity."

Mobile Imp. Co. v. Gass, 142 Ala. 520, 39 So. 229 (a conveyance by a corporation to a director by a vote in which the other directors without the grantee are less than a quorum is merely voidable by the corporation, not void. It is valid subject to the right of the principal or beneficiary to set it aside); *United States Steel Corp. v. Hodge*, 64 N. J. Eq. 807, 54 Atl. 1, 60 L. R. A. 742.

⁸⁸ *Campbell, J.*, in *People v. Township Board of Oberyssel*, 11 Mich. 222; *Pacific Vinegar & Pickle Works v. Smith*, 145 Cal. 352, 78 Pac. 550, 104 Am. St. Rep. 42.

ration, although some courts would allow it to stand upon a showing of fairness and good faith.

In *Hoffman Steam Coal Co. v. Cumberland Coal & Iron Co.*,⁸⁹ Sherman was director of the Cumberland Company, and chairman of a committee to visit the lands of the company and report on the expediency of selling a portion of them. He recommended the sale and received a deed to himself and Dean. It was held that the director, having participated actively in all measures leading to the sale, the transaction could not be upheld if resisted, at least unless the director could sustain the burden of showing the perfect fairness and *bona fides* of the transaction. Where a stranger joins with a director in the purchase of property he is affected by the same disability to make the purchase as attaches to the director. So is a new corporation organized by him.

There is some conflict of opinion as to the effect of a contract or other transaction between a director or other officer of a corporation and the corporation, when it is represented by other officers as to whether it may be avoided by the corporation solely on the ground of the conflict of interests. If the interested officer takes part in making or authorizing the contract or other transaction, and his vote is necessary to bind the corporation, the transaction, as we have just seen, is at least voidable by the corporation whether fair or unfair. The reason for this rule, however, does not apply to the full extent when the interested officer does not take part at all in representing the corporation in the transaction, or where, although he may take part, there are enough votes by other officers to bind the corporation, without counting his vote. As to the effect of such transactions, the courts have not agreed. They are generally held voidable only where unfair or dishonest.

Minority rule.—In view of the fact that it is the duty of individual directors, and other officers intrusted with the management of a corporation, to conduct its affairs to the best advantage, and to act solely in the interest of the corporation, it has been held in some jurisdictions that they will not be permitted to assume a position which will bring their private interests into competition or conflict with this duty. And it has been held, therefore, that a contract or other transaction between a corporation and one or more of its directors or other managing officers, or a contract or transaction in which they are personally interested, is always voidable at the option of the corporation, although it may have been fair

⁸⁹ 16 Md. 456, 77 Am. Dec. 311.

and free from fraud. This doctrine has been applied where the interested director or officer took part in the transaction on behalf of the corporation, although the corporation was also represented by other directors or officers, and his vote or consent was not necessary; and it has also been applied where he took no part on behalf of the corporation, but was at the time, by reason of his official position, under a duty to look out for the interests of the corporation.⁹⁰

This doctrine, however, is not recognized in most jurisdictions. On the contrary, most of the courts have held that a director or other officer of a corporation is not precluded from lending it money and taking a mortgage or other security, selling it property, or purchasing property from it, or otherwise contracting or dealing with it, if for the purpose of the transaction he does not represent the corporation at all, but it is adequately represented by its other directors or officers, and the transaction is entirely free from fraud. And by the weight of authority, a transaction between a director or other officer and the corporation, or a transaction in which a director or other officer is interested, is valid, if fair and entirely free from fraud, even when he has acted as a member of the board in authorizing the same, if there were enough disinterested votes in favor of the transaction to render his vote unnecessary.⁹¹ Directors may, in good faith, advance money to a corporation to assist it in business or keep it a going concern, and may take security for their loan.⁹² But if the corporation is insol-

⁹⁰ *Aberdeen Ry. Co. v. Blakie*, 1 Macq. H. L. Cas. 461; *Cumberland Coal & Iron Co. v. Sherman*, 30 Barb. (N. Y.) 553; *Munson v. Syracuse, G. & C. R. Co.*, 103 N. Y. 58, 8 N. E. 355; *Purchase v. Atlantic Safe Deposit & Trust Co.*, 81 N. J. Eq. 344, 87 Atl. 444; *Stephany v. Marsden*, 75 N. J. Eq. 90, 71 Atl. 598. But see *In re Pyle Works*, [1891] 1 Ch. 173.

⁹¹ *Twin-Lick Oil Co. of W. Va. v. Marbury*, 91 U. S. 587, 23 L. Ed. 328; *McKittrick v. Arkansas Cent. R. Co.*, 152 U. S. 473, 38 L. Ed. 518, 14 Sup. Ct. 661; *Mullanphy Sav. Bank v. Schott*, 135 Ill. 655, 26 N. E. 640, 25 Am. St. Rep. 401; *Minnesota Loan & Trust Co. v. Peteler Car Co.*, 132 Minn. 277, 156 N. W. 255; *Cleveland-Cliffs Iron Co. v. Arctic Iron Co.*, 261 Fed. 15.

If a director has acted with fairness and candor in his dealing with the corporation and the contract is

authorized by a board of impartial persons, the interested director not voting, the corporation may not avoid the agreement so made. *Cowell v. McMillin*, 177 Fed. 25, 39.

⁹² In *Twin-Lick Oil Co. of W. Va. v. Marbury*, 91 U. S. 587, 23 L. Ed. 328, defendant, a director, loaned money to the plaintiff corporation in good faith and to help out the company when it was in extreme embarrassment, taking the same security as any other man would take. When he saw that he could not get the money he bought the same in at an open sale for a fair and reasonable price. Contracts of this class are not absolutely void. They are viewed with jealousy by the courts. They may be set aside on slight grounds. The rule does not go as far as to forbid a director from loaning money to the corporation when the money is needed, and the transaction is

vent they have no right to grant themselves preferences or advantages as creditors over other creditors. A director cannot use his position to benefit himself at the expense either of stockholders or creditors.⁹³

Liberal rule; fairness a question of fact in each case.—The strictness of the rule against contracts by directors with their corporations is being gradually relaxed. By some courts it has been held that such contracts were voidable by the corporation regardless of their fairness. Then other courts held that such contracts were *prima facie* voidable, but would be sustained if proved fair, if the directors' vote was not necessary to procure the corporation's assent. Some recent cases uphold the contract if proved fair, even though the interested directors' votes are necessary to the corporate act of assent.

In *Minnesota Loan & Trust Co. v. Peteler Car Co.*,⁹⁴ it was urged that a mortgage to the directors was voidable without a showing of fraud or bad faith, because the mortgagees took part as directors in the transaction with themselves. The mortgagees were a majority of the directors. They participated in the meeting of the directors which authorized the mortgage, and their presence was necessary to a quorum. It was held that a transaction between a corporation and the majority of its directors acting in its execution, if affirmatively shown upon close scrutiny to be fair and not to involve breach of fiduciary duty will be upheld; and otherwise it may be avoided.

It would seem inadvisable to lay down any hard and fast rule as to the disqualifying effect of adverse interest or to make any legal yardstick. Every case stands on its own bottom. The ultimate question is one of fact, was the bargain a good, fair and honest bargain? Thus directors may hire one of their own number as general manager and increase his salary, if it is a fair and open deal, free from fraud and collusion.⁹⁵ All the courts agree that the fact that, when a director or other officer is dealing with a corporation, the latter is represented by the other directors or offi-

open and free from blame. Such a doctrine would deprive the corporation of aid from those who are best qualified to judge of the necessity of the aid and of those who are most interested in giving it judiciously.

⁹³ *Stuart v. Larson*, 298 Fed. 223, 38 A. L. R. 79.

⁹⁴ 132 Minn. 277, 283, 156 N. W. 255.

⁹⁵ *Ransome Concrete Machinery Co. v. Moody*, 282 Fed. 29, 34, citing *Cowell v. McMillin*, 177 Fed. 25, 39, and *Stewart v. St. Louis, Ft. S. & W. R. Co.*, 41 Fed. 736.

cers, does not leave such officers free to deal unfairly, or to defraud the corporation. If the transaction is not open, fair, and free from all suspicion of fraud, the corporation is entitled to have it set aside, and, in determining whether there has been fraud or unfair dealing, the court will subject the transaction to the most rigid scrutiny. "All contracts made by boards of directors with one of their own number or indeed with any 'insider' are closely scrutinized in equity, and frequently overturned, when, if made with strangers, they would be far more liberally viewed."⁹⁶

According to some courts a contract of a director with the corporation is enforceable only if shown to be fair and honest. According to others it is voidable if shown to be unfair. Some courts require an affirmative showing of fairness and good faith from the fiduciary. Other courts treat the contract as presumptively valid and place the burden on the corporation to show unfairness. The burden of showing that the transaction was fair and free from fraud is generally held to be upon the officer who seeks to enforce it.^{96a}

The certificate of incorporation of the Tide Water Associated Oil Company (Delaware) provides:

"Twelfth: No contract or other transaction between the corporation and any other corporation and no act of the corporation shall in any way be affected or invalidated by the fact that any of the directors of the corporation are pecuniarily or otherwise interested in, or are directors or officers of, such other corporation; any director individually, or any firm of which any director may be a member, may be a party to, or may be pecuniarily or otherwise interested in, any contract or transaction of the corporation, provided that the fact that he or such firm is so interested shall be disclosed or shall have been known to the board of directors or a majority thereof; and any director of the corporation who is also a director or officer of such other corporation or who is so interested may be counted in determining the existence of a quorum at any

⁹⁶ *Ransome Concrete Machinery Co. v. Moody*, 282 Fed. 29, 34; *Twin-Lick Oil Co. of W. Va. v. Marbury*, 91 U. S. 587, 23 L. Ed. 328; *Koehler v. Black River Falls Iron Co.*, 2 Black (U. S.) 715, 17 L. Ed. 339; *Mish v. Main*, 81 Md. 36, 31 Atl. 799.

^{96a} *Crescent City Brewing Co. v. Flanner*, 44 La. Ann. 22, 10 So. 384; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Lazenby v. Henderson*, 241 Mass. 177, 135 N. E. 302.

Burden of proof is on the fiduciary of affirmatively showing that the transaction was fair, made in good faith and upon a full understanding. *Jordan v. Jordan Co.*, 94 Conn. 384, 109 Atl. 181, 519. Compare *Wentz v. Scott*, 10 Fed. (2d) 426, and see dissenting opinion of Gager, J., in *Jordan v. Jordan Co.*, 94 Conn. 384, 109 Atl. 519, that if a director takes himself out of the situation of representing both sides in the transaction, he may deal as a stranger.

meeting of the board of directors of the corporation which shall authorize any such contract or transaction and may vote thereat to authorize any such contract or transaction with like force and effect as if he were not such director or officer of such other corporation or not so interested."

§ 124. Common or interlocking directors.

It is probably the prevailing view that the presence of common directors at a directors' meeting does not permit the avoidance of a contract by either of the corporate parties if only a minority are adversely interested and their influence is not controlling, and the contract is a fair one. Where, however, the same persons constitute a majority of the directors of each of them, any transaction would be held voidable by some courts, without regard to the question of benefit or detriment to either, and although fair and open.⁹⁷

In *O'Conner Min. & Mfg. Co. v. Coosa Furnace Co.*,⁹⁸ certain transfers were made by the Coosa Co. to two other corporations having boards of directors composed of the same persons as those who managed and controlled the vendor. It was held that in transactions between two corporations which have adverse interests, if the same persons act as directors for each of them, either corporation may avoid the contract without regard to the question of advantage or detriment. Such transactions are only voidable and become binding if acquiesced in by the corporations and their stockholders.

In a federal case, it is said:⁹⁹ "Where corporations A and B contract with each other with reference to known adverse and conflicting interests, and have a common director, who withdraws from and abandons his functions as director or officer of A, and negoti-

⁹⁷ *Transvaal Lands Co. v. New Belgium L. & D. Co.*, [1914] 2 Ch. 488, 7 Brit. Rul. Cas. 63 (a corporation cannot make a binding contract with any other company in which a member of the quorum of directors holds shares, unless authorized by the company's articles. By the English rule transactions between companies having common directors are voidable at the option of either). See 2 Machen, *Corporations* 1592; *Interlocking Directorates*, Max Pam, 26 *Harvard Law Rev.* 467, 473: "It should be immaterial how many directors vote in favor of a contract or transaction in which a director has an interest; it should be set aside even though

the interested directors refrain from voting." An individual director may be a dominant force in the conduct of the corporation. 13 *Columbia Law Rev.* 164.

⁹⁸ 95 Ala. 614, 10 So. 290, 36 Am. St. Rep. 251; *Alabama Fidelity Mortgage & Bond Co. v. Dubberly*, 198 Ala. 545, 73 So. 911; *Continental Ins. Co. v. New York & H. R. Co.*, 187 N. Y. 225, 238, 79 N. E. 1026. But see *Booth v. Robinson*, 55 Md. 419, 441. Transaction may not be avoided if the corporation was represented by a quorum, excluding the common directors.

⁹⁹ *Cleveland-Cliffs Iron Co. v. Arctic Iron Co.*, 261 Fed. 15, 19.

ates only on behalf of B, and so notifies his associate directors of A, and they accept his notice and the ensuing responsibility, the strictest rule is only that the eventual contract may be voidable by A, if, in fact, it is unfair to A." This is the rule if the common directors took no part in the transaction. But it may be otherwise if they participate. Even if the common directors are needed for a quorum or a vote the preferable view appears to be that corporations controlled and managed by the same officers and stockholders may deal with each other. If a majority of the directors of corporation A are also directors of corporation B, and without the common directors there would not be a quorum, still contracts may be valid if there is no bad faith or unfairness or collusion.¹⁰⁰ Convenience requires that intercorporate transactions be not arbitrarily restricted.

In *Corsicana Nat. Bank v. Johnson*,¹⁰¹ Mr. Justice Pitney said: "Was there good cause for the rescission? The fact that the same persons were directors and managers of both corporations subjects their dealings *inter sese* to close scrutiny. That two corporations have a majority or even the whole membership of their boards of directors in common does not necessarily render transactions between them void; but transactions resulting from the agency of officers or directors acting at the same time for both must be deemed presumptively fraudulent unless expressly authorized or ratified by the stockholders; and certainly where the circumstances show, as by the undisputed evidence they tended to show in this case, that the transaction would be of great advantage to one corporation at the expense of the other, especially where in addition to this the personal interests of the directors or any of them would be enhanced at the expense of the stockholders, the transaction is

¹⁰⁰ *Evansville Public Hall Co. v. Bank of Commerce*, 144 Ind. 34, 42 N. E. 1097; *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673, 709, 53 Atl. 842. See *San Diego, O. T. & P. B. R. Co. v. Pacific Beach Co.*, 112 Cal. 53, 44 Pac. 333, 33 L. R. A. 788; *Sausalito Bay Land Co. v. Sausalito Imp. Co.*, 166 Cal. 302, 136 Pac. 57; *Boston Acme Mines Development Co. v. Clawson*, — Utah —, 240 Pac. 165; *Smith v. Chase & Baker Piano Mfg. Co.*, 197 Fed. 466, 471.

¹⁰¹ 251 U. S. 68, 91, 64 L. Ed. 141, 40 Sup. Ct. 82. But see *Wentz v. Scott*, 10 Fed. (2d) 426 (there can

be no presumption that the common directors will deal unfairly, and in the absence of evidence tending to show fraud there is a presumption of honest action); *Bentley v. Zelma Oil Co.*, 76 Okla. 116, 184 Pac. 131, 140 (affirmative showing of fairness and good faith required to support contract effected by votes of directors common to both).

No presumption of unfairness arises merely because two corporations which have certain directors in common deal with each other. *San Diego, O. T. & P. B. R. Co. v. Pacific Beach Co.*, 112 Cal. 53, 44 Pac. 333, 33 L. R. A. 788.

voidable by the stockholders within a reasonable time after discovery of the fraud."

The law is thus stated by Clarke, J., in *Geddes v. Anaconda Copper Mining Co.*:¹⁰² "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration. Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality, and we now add in the soundest business policy."

The rule appears to be that the presence of directors on both sides of a transaction does not give an arbitrary right to avoid the transaction, but subjects it to the closest scrutiny of the court; it casts upon those who seek to uphold the transaction the burden of showing that it is fair and absolutely free from fraud. An interlocking directorate is not conclusively presumed to have done wrong in every transaction.¹⁰³ In *Globe Woolen Co. v. Utica Gas & Electric Co.*,¹⁰⁴ the plaintiff corporation sued to compel specific performance of contracts to supply electric current to its mills. The defendant corporation answered that the contracts were made under the dominating influence of a common director, and were unfair and oppressive. Maynard was the plaintiff's chief stockholder, and its president and a member of its board of directors. He was also a director of the defendant, and chairman of its executive committee, holding a single share to qualify him for office. Maynard presided at the defendant's executive committee at which

¹⁰² *Geddes v. Anaconda Copper Min. Co.*, 254 U. S. 590, 599, 65 L. Ed. 425, 41 Sup. Ct. 209, 212, citing *Twin-Lick Oil Co. of W. Va. v. Marbury*, 91 U. S. 587, 588, 23 L. Ed. 328; *Thomas v. Brownville, Ft. K. & P. R. Co.*, 109 U. S. 522, 27 L. Ed. 1018, 3 Sup. Ct. 315; *Wardell v. Union Pac. R. Co.*, 103 U. S. 651, 658, 26 L. Ed. 509; *Corsicana Nat. Bank v. Johnson*, 251 U. S. 68, 90, 64 L. Ed. 141, 40 Sup. Ct. 82. See also, *Omar Oil & Gas Co. v. Bair Oil Co.* (D. C.), 285 Fed. 588, 598; *Leav-*

enworth County Com'rs v. Chicago, R. I. & P. Ry. Co., 134 U. S. 688, 707, 33 L. Ed. 1064, 10 Sup. Ct. 708; 2 *Thompson on Corporations*, ¶¶ 1242, 1243.

¹⁰³ *Irving Bank-Columbia Trust Co. v. Stoddard*, 292 Fed. 815. Agreement and transfers by officers common to corporations are voidable if unfair to either party. Burden of proof to show transaction fair on one who seeks to uphold it.

¹⁰⁴ 224 N. Y. 483, 121 N. E. 378; 13 *Columbia Law Rev.* 164.

the contract was ratified, but did not vote. It was held that the contract was voidable at the election of the defendant. Cardozo, J., said: "The trustee is free to stand aloof, while others act, if all is equitable and fair. He cannot rid himself of the duty to warn and to denounce, if there is improvidence or oppression, either apparent on the surface or lurking beneath the surface, but visible to his practised eye. There slumbered within these contracts a potency of profit which the plaintiff neither ignored in their making nor forgot in their enforcement. . . . The refusal to vote does not nullify as of course an influence and predominance exerted without a vote." A beneficiary about to plunge into a ruinous course of dealing may be betrayed by silence as well as by a vote or by the spoken word.

Ratification.—A contract voidable by reason of adverse interest of directors may be ratified by the stockholders and will become binding by acquiescence. The power of the corporation or the stockholders to avoid the transaction must be exercised within a reasonable time.¹⁰⁵ May interested stockholders vote to ratify a contract, such as a purchase of property, from themselves as directors, as against the protest of the minority?

In *North-West Transp. Co. v. Beatty*,¹⁰⁶ Beatty, a director, desired to sell a steamboat to the company. He secured a controlling amount of stock and brought about the election of two directors who with Beatty voted to buy the ship. This action was submitted to the shareholders and carried by a majority vote, due to Beatty's voting power. The contract was fair, the company needed the

¹⁰⁵ *Busch v. Riddle*, 92 N. J. Eq. 265, 114 Atl. 348; *McClellan v. Bradley*, 282 Fed. 1011; *Union Pac. Ry. Co. v. Credit Mobilier*, 135 Mass. 367, 377: "The contract stands unless avoided or repudiated." See *United States Steel Corporation v. Hodge*, 64 N. J. Eq. 807, 54 Atl. 1, 60 L. R. A. 742 (express authorization by stockholders with knowledge of director's interest); *Fletcher, Corporations*, sec. 2394.

¹⁰⁶ In accord with *North-West Transp. Co. v. Beatty*, L. R. 12 S. C. 589, see *Bjorngaard v. Goodhue Bank*, 49 Minn. 483, 52 N. W. 48 (stockholders are not disqualified to vote by the fact that they have a personal interest in the matter, as upon a proposition to ratify a purchase of

property from themselves which they as directors had assumed to make. It is not to be understood, however, that the majority may use their power of voting oppressively, for the purpose of defrauding the minority); *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527; *Russell v. H. C. Patterson Co.*, 232 Pa. 113, 81 Atl. 136, 36 L. R. A. (N. S.) 199; *General Inv. Co. v. American Hide & Leather Co.*, 97 N. J. Eq. 659, 127 Atl. 659 (stockholders have a right to notice of adverse interest of director by reason of being director in another corporation when proxies are sought and notice given at stockholder's meeting is ineffective to make ratification valid).

boat, and the price was reasonable. It was held that where a voidable contract, fair in its terms, had been entered into by its directors with one of their number as sole vendor, such vendor was entitled to exercise his voting power as a shareholder at a stockholders' meeting to ratify such contract; his doing so could not be deemed oppressive by reason of his individually having a majority of votes. Otherwise the views of the minority on a question of policy in buying the boat would prevail.

Remedies to enforce liability of officers.—When directors or officers are guilty of mismanagement or negligence in conducting corporate affairs, the corporation may sue them at law to recover damages. It is generally held the corporation or its receiver may also sue the delinquent officers in equity to avoid multiplicity of suits against several officers and to do complete justice in one proceeding.¹⁰⁷ In New York, however, it has been held that there is no remedy in equity, as there is not sufficient community of interest in the questions of law and fact.¹⁰⁸ Statutory liability of directors and other officers of a corporation for corporate debts is frequently enforceable only by a creditor's suit in equity for the common benefit of all the creditors.¹⁰⁹

§ 125. The relation between the officers of a corporation and its stockholders individually.—The directors and other officers of a corporation are the agents of the corporation. There is a conflict of opinion as to how far they stand in a fiduciary relation to the stockholders individually in the purchase of stock.

The courts have sometimes said that the directors and other officers of a corporation are trustees for the stockholders, but this is not true if it is meant that they are trustees for the stockholders individually. They are the agents of the stockholders collectively,—that is to say, of the corporation,—but there is, in general, no relation either of agency or of trust as between the officers and the stockholders in their individual capacity.¹¹⁰ It follows from this

¹⁰⁷ *Emerson v. Gaither*, 103 Md. 564, 64 Atl. 26, 8 L. R. A. (N. S.) 738, 7 Ann. Cas. 1114, 1121n; *Cosmopolitan Trust Co. v. Mitchell*, 242 Mass. 95, 136 N. E. 403.

¹⁰⁸ *Dykman v. Keeney*, 154 N. Y. 483, 48 N. E. 894. Compare *German American Coffee Co. v. Diehl*, 86 N. Y. Misc. 547, 149 N. Y. Supp. 413 (amendment 1913); *W. B. Cruik-*

shank Bldg. Corp. v. Egbert, — N. Y. Misc. —, 221 N. Y. Supp. 6.

¹⁰⁹ *In re La Jolla Lumber & Mill Co.*, 243 Fed. 1004; *Westinghouse Elec. & Mfg. Co. v. Reed*, 194 Mass. 590, 80 N. E. 621, 120 Am. St. Rep. 576; *Fletcher, Corporations*, sec. 2672; 43 A. L. R. 1141; ante, § 121.

¹¹⁰ *Allen v. Curtis*, 26 Conn. 456; *Smith v. Hurd*, 12 Mete. (Mass.) 371, 46 Am. Dec. 690; *Deaderick v. Wil-*

that, if the officers of a corporation are guilty of a breach of the duty which they owe to the corporation, the injury is to the corporation, and the stockholders as individuals have no right of action against them, although the value of their stock may be lessened or destroyed.¹¹¹

When it comes to the purchase of stock, is each director to be deemed a fiduciary for each individual stockholder? Must he not only answer all questions, but volunteer all valuable information in his possession while bargaining for the shares? If so, does this doctrine apply to stocks which have a regularly quoted price or market value, or is it limited to small corporations where adequate information is not available to the stockholder? It was formerly the general rule that the directors and other officers of a corporation might purchase stock from the stockholders or otherwise deal with them as individuals, to the same extent as if they were strangers, without being subject to the principles governing transactions between persons occupying a fiduciary relation. The mere failure to disclose information by the director relative to the condition or future prospects of the company bearing on the value of the shares did not invalidate the purchase.¹¹² The director might deal with the stockholder at arm's length.

Some recent decisions show a tendency to break down the old rule that the purchasing director owes no duty to disclose by find-

son, 8 Baxt. (Tenn.) 108; Pomeroy, *Equity Jurisp.* (4th Ed.), sec. 1090. But see Glenn v. Kittingham Brewing Co., 259 Pa. 510, 103 Atl. 340, L. R. A. 1918 D 738, Ann. Cas. 1918 D 769; Farwell v. Pyle-National Elec. Headlight Co., 289 Ill. 157, 124 N. E. 449, 10 A. L. R. 363; Kavanaugh v. Kavanaugh, 226 N. Y. 185, 123 N. E. 148; Proctor v. Farrar, — Mo. —, 213 S. W. 469; Stewart v. Harris, 69 Kan. 498, 77 Pac. 277, 66 L. R. A. 261, 105 Am. St. Rep. 178, 2 Ann. Cas. 873.

¹¹¹ Bayless v. Orne, *Freem. Ch.* (Miss.) 161; Allen v. Curtis, 26 Conn. 456; Smith v. Hurd, 12 Mete. (Mass.) 371, 46 Am. Dec. 690; Pratt v. Bacon, 10 Pick. (Mass.) 123; Seitz v. Michel, 147 Minn. 80, 87, 181 N. W. 102, 12 A. L. R. 1060.

¹¹² Shaw v. Cole Mfg. Co., 132 Tenn. 210, 177 S. W. 479, L. R. A. 1916 B 706; Deaderick v. Wilson, 8 Baxt. (Tenn.) 108; Walsh v. Golden, 130 Mich. 531, 90 N. W. 406. Cp.

Bollstrom v. Duplex Power Co., 208 Mich. 15, 175 N. W. 492; Crowell v. Jackson, 53 N. J. Law 656; Keely v. Black, 91 N. J. Eq. 520, 111 Atl. 22, 20 Columbia Law Rev. 914; Haverland v. Lane, 89 Wash. 557, 154 Pac. 1118; Cahall v. Lofland, 12 Del. 299, 114 Atl. 224, 118 Atl. 1; Seitz v. Frey, 152 Minn. 170, 188 N. W. 266; Waller v. Hodge, 214 Ky. 705, 283 S. W. 1047 (director of corporation purchasing stock must answer questions truthfully, but need not volunteer information concerning value); Hooker v. Midland Steel Co., 215 Ill. 444, 74 N. E. 445, 106 Am. St. Rep. 170; Bawden v. Taylor, 254 Ill. 464, 98 N. E. 941. But see, *Purchase of shares of a corporation by a director from a shareholder*, H. R. Smith, 19 Mich. Law Rev. 698; 8 Mich. Law Rev. 267; 10 Cornell Law Quarterly 509; 27 Yale Law Journal 731; 32 Yale Law Journal 637; Fletcher, *Corporations*, secs. 2566, 2567.

ing exceptions to the rule in special facts giving rise to a duty to make disclosure. A few courts frankly recognize a fiduciary relation in any case.¹¹³

In *Strong v. Repide*,¹¹⁴ decided by the United States Supreme Court in 1909, the court announced the *special facts* doctrine. The defendant was one of five directors, the owner of three-quarters of the stock of the corporation, and the general manager. He was the chief negotiator in a sale of the company's lands to the government. This land was the only valuable asset. The defendant concealed his identity as purchaser of the stock through a broker. He obtained thus the plaintiff's 800 shares for about one-tenth of the amount they became worth by the sale of the lands two or three months thereafter. It was held that under the circumstances it was the duty of the defendant, acting in good faith, to disclose to the plaintiff the facts bearing upon the value of the stock. The just and growing rule is that the directors do stand in a fiduciary relation to the stockholder, so that they are under a duty to disclose all pertinent facts to the stockholder when they purchase stock from him, and if they do not the stockholder will have the right to rescind.¹¹⁵ This, however, should not apply where stock is dealt in upon the open market and has an established market price as contrasted with stock in a small quiet corporation whose affairs are not reported.¹¹⁶

¹¹³ That directors are bound to disclose condition of corporate affairs in dealing with stockholder in regard to stock, see *Dawson v. National Life Ins. Co.*, 176 Iowa 362, 157 N. W. 929, Ann. Cas. 1918 B 230, L. R. A. 1916 E 878; *Jacquith v. Mason*, 99 Neb. 509, 156 N. W. 1041, L. R. A. 1917 F 817; *Oliver v. Oliver*, 118 Ga. 362, 45 S. E. 232; *Stewart v. Harris*, 69 Kan. 498, 77 Pac. 277, 66 L. R. A. 261, 105 Am. St. Rep. 178, 2 Ann. Cas. 873; *Commonwealth Trust Co. v. Seltzer*, 227 Pa. 410, 76 Atl. 77, 136 Am. St. Rep. 896; 7 R. C. L., p. 459, sec. 443; note 4 Brit. Rul. Cas. 797.

¹¹⁴ 213 U. S. 419, 53 L. Ed. 853, 29 Sup. Ct. 521; *McManus v. Durant*, 168 N. Y. App. Div. 643, 657, 154 N.

Y. Supp. 580, 590. See *Huston v. Harrington*, 58 Wash. 51, 107 Pac. 874; *Poole v. Camden*, 79 W. Va. 310, L. R. A. 1917 E 988, 98 S. E. 454; 8 Michigan Law Rev. 268.

¹¹⁵ *Dawson v. National Life Ins. Co.*, 176 Iowa 362, 157 N. W. 929, L. R. A. 1916 E 878, Ann. Cas. 1918 B 230: "There is something wrong in any rule which will enable a director legally by his position to obtain for himself alone profits all have won." Citing *Wilgus*, 8 Mich. Law Rev. 267 and 81 Cent. Law Journal 256. See note, *Shaw v. Cole Mfg. Co.*, L. R. A. 1916 B 708.

¹¹⁶ See *Walker*, 32 Yale Law Journal 637, *Duty of disclosure by director*. Cp. *Berle*, 25 Mich. Law Rev. 827.

CHAPTER XI.

TENURE OF OFFICE AND COMPENSATION OF OFFICERS.

§ 126. Election or appointment, and qualification of directors and other officers.—Directors and other officers must have the qualifications, if any, prescribed by the charter or general statutory law, but no special qualification is necessary, unless so required. By-laws may prescribe qualifications, but they may be waived by the corporation.

One who holds an office and performs its duties with the consent of the corporation is a *de facto* officer, although his appointment or election may have been illegal or irregular, and his acts as such are binding so far as third persons are concerned, and as against himself.

A person who has not the qualifications for office prescribed by the charter or statute is not strictly a *de facto* officer, but he cannot set up his disqualification to escape liability as such; and the corporation, if it holds him out as an officer, will be estopped as against persons dealing with him in good faith.

Primarily, and in the absence of provision to the contrary, the power to elect directors and other officers is in the stockholders.¹ But the power may be and usually is conferred upon the directors as to other officers. If the charter or statute vests the power to elect or appoint officers in the board of directors, they cannot be elected or appointed by the stockholders.²

Qualifications.—Very often the charter, general law, or by-laws expressly require that directors shall be stockholders, and in such a case persons who are not stockholders are ineligible.³ It has

¹ In *re* A. A. Griffing Iron Co., 63 N. J. Law 168, 357, 41 Atl. 931.

² In *re* St. Helen Mill Co., 3 Sawy. 88, Fed. Cas. No. 12,222; *Walsenburg Water Co. v. Moore*, 5 Colo. App. 144, 38 Pac. 60; *State ex rel. Badger Telephone Co. v. Rosenow*, 174 Wis. 9, 182 N. W. 324; *Rideout v. National Homestead Ass'n*, 14 Cal. App. 349, 112 Pac. 192.

³ See *Despatch Line of Packets v. Bellamy Mfg. Co.*, 12 N. H. 205, 37 Am. Dec. 203; *Schmidt v. Mitchell*, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427; In *re* *Elias*, 17 N. Y. Misc. 718, 40 N. Y. Supp. 910; *Chemical Nat. Bank of New York v. Colwell*, 132 N. Y. 250, 30 N. E. 644. See *Parsons v. Rinard Grain Co.*, 186 Iowa 1017, 173 N. W. 276.

generally been held that beneficial ownership is not necessary, and that a person who holds the legal title to stock on the books of the corporation is qualified, although the stock may have been transferred to him merely for the purpose, and the beneficial ownership may be in another.⁴ A person is eligible if he holds stock as executor or trustee, and is entitled to vote the same.⁵ According to the better opinion, when the ownership of stock is necessary to qualify one as a director, a person ceases to be a director if he ceases to be a stockholder, without any proceedings to remove him, although he may have owned stock when elected,⁶ but the corporation may be estopped to repudiate his acts if it allows him to continue to act after he has ceased to be a stockholder.⁷

De facto officers.—Persons who hold office as directors, or other officers, with the consent of the corporation, and under color of an election or appointment, are *de facto* officers, although their election or appointment may have been illegal, and their acts as such, in so far as third persons are concerned, are just as valid and binding upon the corporation as if they were officers *de jure*.⁸ And the validity of their acts is not in any way affected by the fact that

⁴ Kardo Co. v. Adams, 231 Fed. 950, 965; People ex rel. Matthiessen v. Lihme, 269 Ill. 351, 109 N. E. 1051, Ann. Cas. 1916 E 959; Pulbrook v. Richmond Consol. Min. Co., 9 Ch. Div. 610; State v. Leete, 16 Nev. 242; In re Argus Printing Co., 1 N. D. 434, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; In re St. Lawrence Steamboat Co., 44 N. J. Law 529; In re Leslie, 58 N. J. Law 609, 33 Atl. 954; Johnson v. York Coal & Coke Co., 182 Ky. 303, 206 S. W. 611.

⁵ Schmidt v. Mitchell, 101 Ky. 570, 72 Am. St. Rep. 427; In re Santa Eulalia Silver Mining Co., 51 Hun (N. Y.) 640, 41 S. W. 929, 4 N. Y. Supp. 174. See Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N. W. 754, 150 N. W. 1101.

⁶ Johnson v. York Coal & Coke Co., 182 Ky. 303, 206 S. W. 611; Chemical Nat. Bank v. Colwell, 132 N. Y. 250, 30 N. E. 644; Sinclair v. Dwight, 9 N. Y. App. Div. 297, 41 N. Y. Supp. 193; Orr Water Ditch Co. v. Reno Water Co., 17 Nev. 166, 30 Pac. 695. Contra, Nathan v. Tompkins, 82 Ala. 437, 2 So. 747; Lippman v. Kehoe

Stenograph Co., 11 Del. 412, 102 Atl. 988. See Robinson v. Blood, 151 Cal. 504, 91 Pac. 258.

⁷ Beardsley v. Johnson, 121 N. Y. 224, 24 N. E. 380; San Jose Sav. Bank v. Sierra Lumber Co., 63 Cal. 179; Robinson v. Blood, 151 Cal. 504, 91 Pac. 258; Seal of Gold Min. Co. v. Slater, 161 Cal. 621, 120 Pac. 15; Kuser v. Wright, 52 N. J. Eq. 825, 31 Atl. 397.

⁸ Anglo-Californian Bank v. Mahoney Min. Co., 5 Sawy. 255, Fed. Cas. No. 392, aff'd in Mahoney Min. Co. v. Anglo-Californian Bank, 104 U. S. 192, 26 L. Ed. 707; Herbst v. Held, 194 Iowa 679, 190 N. W. 153; Merchants' Nat. Bank v. Citizens' Gas Light Co., 159 Mass. 505, 34 N. E. 1083, 38 Am. St. Rep. 453; People v. Northern R. Co., 42 N. Y. 217; Carpenter v. Clark, 217 Mich. 63, 185 N. W. 868; Hamilton Trust Co. v. Clemes, 17 N. Y. App. Div. 152, 45 N. Y. Supp. 141, aff'd 163 N. Y. 423, 57 N. E. 614; Savage v. Miller, 56 N. J. Eq. 432, 36 Atl. 578, 39 Atl. 665; Richards v. Farmers' & Mechanics' Institute, 154 Pa. St. 449, 26 Atl. 210, 35 Am. St. Rep. 848.

a court afterwards declares the election or appointment void, and ousts them from the office.⁹ *De facto* officers cannot themselves set up the fact that they are not officers *de jure* to escape liability to the corporation or to creditors for their acts as such, or their omissions,¹⁰ or to avoid the doctrine in relation to dealings between an officer and the corporation.¹¹ According to the better opinion, except as above stated, the doctrine in relation to *de facto* officers does not apply as between the officers and the corporation or stockholders. Some of the courts have held, therefore, that a call for unpaid subscriptions by a merely *de facto* board of directors is not valid.¹² And a person cannot enforce rights dependent upon his legal position as an officer, where he is merely an officer *de facto*,¹³ as a claim for salary, for example.¹⁴

To be an officer *de facto* one must be in actual possession of the office under claim and color of an election or appointment, and in the exercise of its functions and discharge of its duties. He must hold office under some degree of notoriety, and exercise continuous acts of an official character.¹⁵

"The theory of the doctrine of officers *de facto* . . . is that, though wrongfully in office, justice and necessity require that their acts, done within the scope of their official authority and duty, be sustained, to the end that the rights and interests of third persons be preserved and protected." ¹⁶

⁹ *Anglo-Californian Bank v. Mahoney Min. Co.*, 5 Sawy. 255, Fed. Cas. No. 392, aff'd in *Mahoney Min. Co. v. Anglo-Californian Bank*, 104 U. S. 192, 26 L. Ed. 707; and other cases above cited.

¹⁰ *Easterly v. Barber*, 65 N. Y. 252; *McDowall v. Sheehan*, 129 N. Y. 200, 29 N. E. 299; *Bank of St. Mary's v. St. John, Powers & Co.*, 25 Ala. 566; *Hall v. West Chester Publishing Co.*, 180 Pa. St. 561, 37 Atl. 106.

¹¹ *Stetson v. Northern Inv. Co.*, 104 Iowa 393, 73 N. W. 869; *Lazenby v. Henderson*, 241 Mass. 177, 135 N. E. 302 (one not legally elected held director *de facto* and subject to fiduciary obligations of a director).

¹² *Moses v. Tompkins*, 84 Ala. 613, 4 So. 763. Contra, *San Joaquin Land & Water Co. v. Beecher*, 101 Cal. 70, 35 Pac. 349. See *Fletcher, Corporations*, sec. 673.

¹³ *Riddle v. Bedford County*, 7 Serg. & R. (Pa.) 386; *Waterman v.*

Chicago & I. R. Co., 139 Ill. 658, 29 N. E. 689, 15 L. R. A. 418, 32 Am. St. Rep. 228; *Shellenberger v. Patterson*, 168 Pa. St. 30, 31 Atl. 943; *Lebanon & R. Gravel Road Co. v. Adair*, 85 Ind. 244.

¹⁴ *Waterman v. Chicago & I. R. Co.*, 139 Ill. 658, 29 N. E. 689, 15 L. R. A. 418, 32 Am. St. Rep. 228; *Fletcher, Corporations*, sec. 2765. But see *Hess v. Kismet State Bank*, 106 Kan. 701, 189 Pac. 919.

¹⁵ *Waterman v. Chicago & I. R. Co.*, 139 Ill. 658, 29 N. E. 689, 15 L. R. A. 418, 32 Am. St. Rep. 228; *Ex parte State*, 201 Ala. 59, 77 So. 353. See *In re Campbell County Hardware Co.*, 15 Fed. (2d) 78.

¹⁶ *Herbst v. Held*, 194 Iowa 679, 190 N. W. 153, quoting *Buck v. Hawley*, 129 Iowa 406, 105 N. W. 688. See *Hussey v. Smith*, 99 U. S. 20, 25 L. Ed. 314; *State v. Carroll*, 38 Conn. 449, 9 Am. Rep. 409.

Effect of disqualification.—There is some authority that if a person who is not eligible as a director or other officer under the charter or statute is elected, he does not become even a *de facto* officer.¹⁷ It does not follow, however, that ineligibility of a person who has been elected an officer will invalidate his acts as such. Persons dealing with a corporation are not required to ascertain whether the directors or other officers of the corporation have the prescribed qualifications, and, therefore, acts of a director or other officer are valid, so far as innocent third persons are concerned, although he may not have been qualified, if he has been elected or appointed by the corporation, and permitted to act for it.¹⁸

§ 127. Tenure of office, and removal or resignation.—If the term of an officer is fixed by the charter or statute, the corporation cannot remove him, except for cause, prior to the end of his term, unless the power is expressly given; but where the term of office is not so fixed, the officer is removable at the pleasure of the corporation. Even when there is a contract, he may be removed, although the corporation may thereby incur liability for breach of the contract.

An officer may resign at any time unless prevented by contract or by express charter or statutory provisions.

The tenure of the directors or other officers of a corporation is generally fixed by the charter or general law, or by the by-laws of the corporation. If the term of an officer is not so fixed, and he is elected or appointed without any provision or agreement as to his term, he holds the office at the pleasure of the corporation. Directors, trustees, or other officers of a corporation, elected or appointed for a certain time, hold over after the expiration of their

¹⁷ Hamley's Case, 5 Ch. Div. 705; Schmidt v. Mitchell, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427; In re Newcomb, 42 N. Y. St. Rep. 442, 18 N. Y. Supp. 16; Richards v. Attleborough Nat. Bank, 148 Mass. 187, 19 N. E. 353, 1 L. R. A. 781. Compare, however, San Jose Sav. Bank v. Sierra Lumber Co., 63 Cal. 179; Beardsley v. Johnson, 121 N. Y. 224, 24 N. E. 380; Delaware & H. Canal Co. v. Pennsylvania Coal Co., 21 Pa. St. 131; Hygienic Health Food Co. v. Grant, 187 Cal. 431, 202 Pac. 653.

¹⁸ Lazenby v. Henderson, 241 Mass. 177, 135 N. E. 302: "Third persons had a right to assume that there was no defect in his election, and to hold him subject to the fiduciary obligations of a director." Despatch Line of Packets v. Bellamy Mfg. Co., 12 N. H. 205, 37 Am. Dec. 203; Beardsley v. Johnson, 121 N. Y. 224, 24 N. E. 380; Kuser v. Wright, 52 N. J. Eq. 825, 31 Atl. 397, rev'g Wright v. First Nat. Bank, 52 N. J. Eq. 392, 28 Atl. 719.

term until their successors are elected or appointed, to such an extent, at least, as to be officers *de facto*.¹⁹

Removal of officers by the corporation.—If an officer of a corporation has been elected or appointed, and is serving under a contract with the corporation for a fixed term, he cannot be lawfully removed at pleasure, either by the stockholders, or by the directors or other superior officers, except for incompetency or violation of the contract between him and the corporation. If he is removed without cause, his authority to represent the corporation ceases, but the corporation will be liable to him for the breach of contract, as in other cases of employment.²⁰ Even when there is a contract for a fixed term with an officer, he may, like any other agent or servant under contract, be removed for breach of the contract, by unauthorized acts, misapplication of funds, neglect, or incompetency.²¹ There is no power, either in the stockholders or the directors, to remove directors or other officers before the expiration of their term, except for cause, if the term of office is fixed by the charter of the corporation, or by a general statute.²² But if the term of an officer is not fixed by any contract binding upon the corporation, nor by the charter or general law, he may be removed at any time, with or without cause, by the stockholders, or, generally, by the officer or officers by whom he was appointed, and the removal will impose no liability to him on the part of the corporation.²³ Except as stated above, the directors have implied

¹⁹ *People v. Runkle*, 9 Johns. (N. Y.) 147; *Trustees of Vernon Society v. Hills*, 6 Cow. (N. Y.) 23, 16 Am. Dec. 429; *Kent County Agricultural Society v. Houseman*, 81 Mich. 609, 46 N. W. 15; *Jenkins v. Baxter*, 160 Pa. St. 199, 28 Atl. 682; *Weil v. Defenbach*, 36 Idaho 37, 203 Pac. 1025.

²⁰ *Douglass v. Merchants' Ins. Co.*, 118 N. Y. 484, 23 N. E. 806, 7 L. R. A. 822; *In re A. A. Griffing Iron Co.*, 63 N. J. Law 168, 357, 41 Atl. 931, 46 Atl. 1097.

²¹ *Bainbridge v. Smith*, 60 Law T. (N. S.) 879; *State v. Kupferle*, 44 Mo. 154, 100 Am. Dec. 265. See *Fletcher, Corporations*, sec. 1823.

²² Directors, once elected, cannot be removed, even though inefficient. *People ex rel. Manice v. Powell*, 201 N. Y. 194, 94 N. E. 634. "The individual directors making up the

board are not mere employees, but a part of the elected body of officers constituting the executive agents of the corporation . . . without some statute or provision of the charter, a director cannot be removed or suspended from office until the end of his term, at least without cause." *Toledo Traction, Light & Power Co. v. Smith*, 205 Fed. 643; *Imperial Hydropathic Hotel Co. v. Hampson*, 23 Ch. Div. 1; *Nathan v. Tompkins*, 82 Ala. 437, 2 So. 747; *Ohio & M. Ry. Co. v. State*, 49 Ohio St. 668, 32 N. E. 933; *In re Korff*, 198 N. Y. App. Div. 553, 190 N. Y. Supp. 664; *Hatch v. Johnson Loan & Trust Co.*, 79 Fed. 828; *State v. Kuehn*, 34 Wis. 229.

²³ *Douglass v. Merchants' Ins. Co.*, 118 N. Y. 484, 23 N. E. 806, 7 L. R. A. 822; *State v. Kupferle*, 44 Mo. 154, 100 Am. Dec. 265; *In re A. A. Griffing Iron Co.*, 63 N. J. Law 163,

authority to remove all officers appointed by them,²⁴ but they have no power, unless the authority is expressly conferred, to remove officers appointed or elected by the stockholders.²⁵ The president of a corporation has no power, unless there is express provision therefor, to remove an officer appointed by the board of directors, but the power of removal is in the board.²⁶ Nor has a court of equity jurisdiction to remove the legally elected or appointed officers of a corporation, in the absence of a statute, on the ground of mismanagement of the affairs of the corporation, or neglect, or other cause. The power of removal on this ground is in the corporation itself only.²⁷ In some states statutes authorize proceedings to remove corporate officers on various grounds.²⁸

§ 127a. Salary and compensation of directors and other officers.—The directors and other managing officers of a corporation, not being mere ministerial officers, are entitled to no compensation at all for performing the ordinary duties of their office, unless there is an express contract, or an express provision for compensation in the charter, statutes, or by-laws. The law, however, will imply a promise to pay such officers for services outside of the duties of their office, if the circumstances are such that it may reasonably be presumed that the services were not intended to be gratuitous. The officers of a corporation cannot agree to pay, or pay, for past services, unless they were rendered under circumstances from which the law would imply a promise to pay therefor.

There is some conflict in the decisions as to the right of the directors and other officers of a corporation to salary or other compensation, in the absence of an express provision or agreement

357, 41 Atl. 931; *People v. Higgins*, 15 Ill. 110; *Brindley v. Walker*, 221 Pa. 287, 70 Atl. 794, 23 L. R. A. (N. S.) 1293.

²⁴ *People v. Higgins*, 15 Ill. 110; *Sparks v. Farmers' Bank of Delaware*, 3 Del. Ch. 274; *Brindley v. Walker*, 221 Pa. 287, 70 Atl. 794, 23 L. R. A. (N. S.) 1293; *supra*, note 23.

²⁵ *Archer v. People's Sav. Bank*, 88 Ala. 249, 7 So. 53; *Brindley v. Walker*, 221 Pa. 287, 70 Atl. 794, 23 L. R. A. (N. S.) 1293; *Bruch v. National Guarantee Credit Corp.*, 13 Del. Ch. 180, 116 Atl. 738.

²⁶ *Granger v. American Brewing*

Co., 25 N. Y. Misc. 302, 54 N. Y. Supp. 695; *Mobile, J. & K. City R. Co. v. Owen*, 121 Ala. 505, 25 So. 612. See *Birmingham Realty Co. v. Hale*, 16 Ala. App. 460, 78 So. 723; *Magpie Gold Min. Co. v. Sherman*, 23 S. D. 232, 121 N. W. 770, 20 Ann. Cas. 595.

²⁷ *Attorney General v. Earl of Clarendon*, 17 Ves. Jr. 491; *Neall v. Hill*, 16 Cal. 145, 76 Am. Dec. 508; *Robertson v. Bullions*, 11 N. Y. 243; *Hedges v. Paquett*, 3 Ore. 77; *Bayless v. Orne*, Freem. Ch. (Miss.) 161.

²⁸ *Fletcher, Corporations*, sec. 1820.

therefor, but the following general rules are well settled in most jurisdictions:

It is settled, in all jurisdictions, perhaps, that the directors or trustees of a corporation are not entitled to salary or other compensation when they perform nothing more than the usual and ordinary duties pertaining to their office, unless there is an express provision or agreement for compensation before the services are performed. They cannot recover on implied contract for what the services were reasonably worth, for the law will not imply a promise on the part of the corporation to pay; and it can make no difference, in the application of this rule, that the services were performed with the expectation of compensation, or with the general understanding among the directors themselves that they should receive compensation.²⁹

"The doctrine is well settled in this court," it was said in an Illinois case, "that the law will not imply a promise on the part of a private corporation to pay its officers for the performance of their usual duties. In order that such officers may legally demand and recover for such services, . . . it must appear that a by-law or resolution had been adopted authorizing and fixing such allowance before the services were rendered. . . . The rule is analogous to that governing trustees generally, who, at common law, were not entitled to compensation, except as there was warrant therefor in the contract or statute under which they acted."³⁰

With respect to the right of the executive officers of a corporation, as the president, vice president, treasurer, secretary, etc., to recover compensation for their services, the decisions are conflicting. Some of the courts hold that such an officer, at least, if he is also a director or stockholder, as is generally the case, is not entitled to recover compensation for performing the ordinary duties of his office, unless there is an express agreement therefor, by virtue of a by-law or a resolution of the directors fixing the compensation

²⁹ *Corinne Mill, Canal & Stock Co. v. Toponce*, 152 U. S. 405, 38 L. Ed. 493, 14 Sup. Ct. 632; *In re George Newman & Co.* [1895] 1 Ch. 674; *Lofland v. Cahall*, 13 Del. 384, 118 Atl. 1; *Cheaney v. Lafayette, B. & M. R. Co.*, 68 Ill. 570, 18 Am. Rep. 584; *Ellis v. Ward*, 137 Ill. 509, 25 N. E. 530; *Fox v. Arctic Placer Min. & Mill Co.*, 229 N. Y. 124, 128 N. E. 154; *Mather v. Eureka Mower Co.*,

118 N. Y. 629, 23 N. E. 993; *Wood v. Lost Lake & C. Mfg. Co.*, 23 Ore. 20, 23 Pac. 840, 37 Am. St. Rep. 651; *Martindale v. Wilson-Cass Co.*, 134 Pa. St. 348, 19 Atl. 680, 19 Am. St. Rep. 706. *Cp. Basset v. Fairchild*, 132 Cal. 637, 64 Pac. 1082, 52 L. R. A. 611.

³⁰ *Ellis v. Ward*, 137 Ill. 509, 25 N. E. 530

before performance of the services.³¹ It has sometimes been said broadly that "when an officer of a corporation performs the usual and ordinary duties of his office, as defined by the charter or by-laws, he cannot recover compensation therefor unless it has been so specially agreed," without restricting the rule to persons who are also directors, and charged with the management and control of the corporate property and funds.³²

This view, however, is not supported, either by sound reason or by the weight of authority. The reason for the doctrine that the directors of a corporation are not entitled to compensation in the absence of express provision or agreement, either when acting as directors or in other offices, does not apply to ministerial officers and employees—as a manager, superintendent, treasurer, secretary, cashier, etc.—who are not directors, and have no control over the property and funds of the corporation, even though they may be stockholders; and if such an officer or employee is elected or appointed to perform valuable services for the corporation under circumstances indicating intention and expectation of payment, but without any express contract, the law will imply a promise on the part of the corporation to pay a reasonable compensation.³³

It is clear that the rule in relation to directors and other managing officers does not apply to mere ministerial officers and clerks employed by the corporation or the directors, and who are neither directors nor stockholders. If their salary is not fixed, they are

³¹ *Ellis v. Ward*, 137 Ill. 509, 25 N. E. 530; *Rosehill Cemetery Co. v. Dempster*, 223 Ill. 567, 79 N. E. 276; *Kilpatrick v. Penrose Ferry Bridge Co.*, 49 Pa. St. 118, 88 Am. Dec. 497; *Martindale v. Wilson-Cass Co.*, 134 Pa. St. 348, 19 Atl. 680, 19 Am. St. Rep. 706; *Crumlish's Adm'r v. Central Improvement Co.*, 38 W. Va. 390, 18 S. E. 456, 23 L. R. A. 120, 45 Am. St. Rep. 872; *Citizens' Nat. Bank v. Elliott*, 55 Iowa 104, 7 N. W. 410, 39 Am. Rep. 167; *Wood v. Lost Lake & C. Mfg. Co.*, 23 Ore. 20, 23 Pac. 848, 37 Am. St. Rep. 651; *Fields v. Victor Building & Loan Co.*, 73 Okla. 207, 175 Pac. 529; *Lowe v. Ring*, 123 Wis. 370, 101 N. W. 698, 3 Ann. Cas. 731; *Stevenson v. Sickelsteel Lumber Co.*, 219 Mich. 18, 188 N. W. 449; *Whitewater Tel. Co. v. Cory*, 117 Kan. 463, 232 Pac. 609.

³² *SeEVERS, J., in Citizens' Nat.*

Bank v. Elliott, 55 Iowa 104, 7 N. W. 470, 39 Am. Rep. 167. In this case, however, the statement quoted is mere dictum, as the officers who were there claiming salary were also directors.

³³ *Bee v. San Francisco & H. B. R. Co.*, 46 Cal. 248; *Cheaney v. Lafayette, B. & M. Ry. Co.*, 68 Ill. 570, 18 Am. Rep. 584; *Holder v. Lafayette, B. & M. Ry. Co.*, 71 Ill. 106, 22 Am. St. Rep. 89; *Felton v. West Iron Mountain Min. Co.*, 16 Mont. 81, 40 Pac. 70; *Naveco Hardwood Co. v. Bass*, 214 Ala. 553, 108 So. 452 (no presumption that general manager acts without compensation); *Basset v. Fairchild*, 132 Cal. 637, 64 Pac. 1082, 52 L. R. A. 611; *National Loan & Investment Co. v. Rockland Co.*, 94 Fed. 335; *Smith v. Long Island R. Co.*, 102 N. Y. 190, 6 N. E. 397. See 7 E. C. L. 464.

entitled to recover reasonable compensation, unless it appears that no compensation was intended.⁸⁴

By the weight of authority, the doctrine that the directors and other managing officers of a corporation are not entitled to compensation, in the absence of express provision or agreement therefor, does not apply to unusual or extraordinary services,—that is, services which do not properly pertain to their office, and are rendered by them outside of their regular duties. If such services are rendered by a director or other officer at the request of the corporation or the board of directors, with the understanding that they are to be paid for, the law will imply a promise, in the absence of any special agreement, to pay what they are reasonably worth.⁸⁵

Even when directors or other officers perform services outside of the ordinary duties of their office, and in the case of services performed by persons other than directors and managing officers, no compensation can be recovered on implied contract where it was provided or agreed that no compensation should be paid,⁸⁶ or where, although there is neither an express provision nor an agreement to this effect, the circumstances are such as to show that no compensation was intended or expected.⁸⁷ A promise will not be

⁸⁴ *Smith v. Long Island R. Co.*, 102 N. Y. 190, 6 N. E. 397; *Waller v. Bank of Kentucky*, 3 J. J. Marsh. (Ky.) 206; *Kryger v. Railway Track Cleaner Mfg. Co.*, 46 Minn. 500, 49 N. W. 255.

⁸⁵ *Corinne Mill, Canal & Stock Co. v. Toponce*, 152 U. S. 405, 38 L. Ed. 493, 14 Sup. Ct. 632; *Cheaney v. Lafayette, B. & M. Ry. Co.*, 68 Ill. 570, 18 Am. St. Rep. 584; *Ten Eyck v. Pontiac, O. & P. A. R. Co.*, 74 Mich. 226, 41 N. W. 905, 3 L. R. A. 378, 16 Am. St. Rep. 633. Compare, however, *Kilpatrick v. Penrose Ferry Bridge Co.*, 49 Pa. St. 118, 88 Am. Dec. 497; *Althouse v. Coughlin Colliery Co.*, 227 Pa. 580, 76 Atl. 316, 136 Am. St. Rep. 908; *Cheaney v. Lafayette, B. & M. Ry. Co.*, 68 Ill. 570, 18 Am. St. Rep. 584.

See *Sears v. Corr Mfg. Co.*, 242 Mass. 395, 136 N. E. 266; *Spence v. Sturgis Go-Cart Co.*, 217 Mich. 147, 186 N. W. 393; *Lofland v. Cahall*, 12 Del. Ch. 384, 118 Atl. 1; *Alexander v. Equitable Life Assur. Soc.*, 233 N. Y. 300, 135 N. E. 509.

⁸⁶ See *Olney v. Chadsey*, 7 R. I. 224; *Hodges v. Rutland & B. R. Co.*,

29 Vt. 220; *First Nat. Bank v. Drake*, 29 Kan. 311, 44 Am. Rep. 646.

⁸⁷ *Lindsey v. Pasco Power & Water Co.*, 203 Fed. 251; *Wood's Sons Co. v. Schaefer*, 173 Mass. 443, 53 N. E. 881, 73 Am. St. Rep. 305; *Alexander v. Equitable Life Assur. Soc.*, 233 N. Y. 300, 135 N. E. 509; *Eakins v. American White Bronze Co.*, 75 Mich. 568, 42 N. W. 982; *Campbell v. King's Daughter's General Hospital*, 96 W. Va. 539, 123 S. E. 396.

It was said in *Alexander v. Equitable Life Assur. Soc.*, 233 N. Y. 300, 135 N. E. 509: "The general rule is that in the absence of an express contract, an officer or director of a corporation cannot recover for services rendered without proving they were outside of his duties as such officer or director, and in addition thereto that the same were rendered with the expectation by both parties that they should be paid for." Citing *Fox v. Arctic Placer Min. & Mill Co.*, 229 N. Y. 124, 131, 128 N. E. 154; *Marcy v. Shelburne Falls & Colrain St. R. Co.*, 210 Mass. 197, 96 N. E. 130; *Fitzgerald & Mallory Const. Co. v. Fitzgerald*, 137 U. S.

implied from the mere fact that the services were rendered, and that they were valuable, but it must also appear "that they were rendered under such circumstances as to raise the fair presumption that the parties intended and understood that they were to be paid for; or, at least, that the circumstances were such that a reasonable man in the same situation with the person who receives and is benefited by them would and ought to understand that compensation was to be paid for them."³⁸

Power to fix compensation.—In the absence of provision to the contrary, the compensation of the directors must be fixed by the stockholders by vote, resolution, or by-laws. The directors cannot fix their own salaries, unless expressly authorized by the charter or by the stockholders to do so.³⁹ Nor can other officers fix their own salaries, unless expressly authorized.⁴⁰

It is within the powers of the directors to fix the salaries of other officers appointed by them, although from their own number, unless there is some provision to the contrary, and to fix the compensation to be paid officers for extraordinary services which they engage or authorize.⁴¹ A director, however, cannot vote at a directors' meeting on a resolution fixing his own salary or other compensation as the incumbent of another office, or for services to be performed by him outside of the ordinary duties of his office, and if he does so, and his vote is necessary to the passage of the resolution, the resolution is at least voidable at the option of the corporation, and in some jurisdictions it is absolutely void.⁴² A cor-

98, 111, 34 L. Ed. 608, 11 Sup. Ct. 36.

³⁸ *Pew v. First Nat. Bank of Gloucester*, 130 Mass. 391.

³⁹ *In re George Newman & Co.*, [1895] 1 Ch. 674; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Palmer v. Scheffel*, 183 N. Y. App. Div. 77, 170 N. Y. Supp. 588; *Gardner v. Butler*, 30 N. J. Eq. 702; *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, 53 N. W. 218, 17 L. R. A. 412; *Holder v. Lafayette, B. & M. Ry. Co.*, 71 Ill. 106, 22 Am. Rep. 89; *Russell v. Henry C. Patterson Co.*, 232 Pa. St. 113, 81 Atl. 136, 36 L. R. A. (N. S.) 199.

Directors of a corporation occupy a fiduciary relationship and cannot fix their own salaries as directors or officers, so as to bind the corporation. *Bennett v. Klipto Loose Leaf Co.*, — Iowa —, 207 N. W. 228; 14 C. J.

143; 4 *Fletcher, Corporations*, sec. 2752.

⁴⁰ *Church v. Church Cement Co.*, 75 Minn. 85, 77 N. W. 548; *Wayne Pike Co. v. Hammons*, 129 Ind. 368, 27 N. E. 487; *Kelsey v. Sargent*, 40 Hun (N. Y.) 150; *Stevenson v. Sickelsteel Lumber Co.*, 219 Mich. 18, 188 N. W. 449. But see *Bagaley v. Pittsburgh & L. S. Iron Co.*, 146 Pa. St. 478, 23 Atl. 837.

⁴¹ *Ransome Concrete Machinery Co. v. Moody*, 282 Fed. 29; *Waite v. Windham County Min. Co.*, 37 Vt. 608; *Outterson v. Fonda Lake Paper Co.*, 66 Hun (N. Y.) 629, 20 N. Y. Supp. 980; *Bagaley v. Pittsburgh & L. S. Iron Co.*, 146 Pa. St. 478, 23 Atl. 837.

⁴² *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, 53 N. W. 218, 17

poration is not liable for services rendered by directors on special contracts carried by the votes of interested directors. Directors are not entitled to retain compensation voted themselves for services rendered by them where no authority or approval was given by the stockholders, even if outside their duties as directors. Their plain duty is to obtain the approval of the stockholders.⁴³ But the resolution is not invalid merely because the interested director voted, if there were enough votes without him to constitute a majority of the board,⁴⁴ and in some jurisdictions it is not voidable unless it is unfair and unreasonable.⁴⁵ If the board, without his participation, has subsequently in good faith ratified the resolution by a majority vote, it is valid.⁴⁶ And of course, the action of the directors, if voidable, and not void, may be ratified by the stockholders.⁴⁷

Both the stockholders and directors, in fixing compensation of officers, must act in good faith, and reasonably. While stockholders may vote at corporate meetings in fixing their own salary as officers, and may elect directors, they cannot take advantage of their ownership of a controlling interest to vote themselves excessive salaries, or cause excessive salaries to be voted to them by directors whom they control. Nor can the directors vote excessive compensation to themselves or others. If they do so, a court of equity will

L. R. A. 412; *Hardee v. Sunset Oil Co.*, 56 Fed. 51; *Shattuck v. Oakland Smelting & Refining Co.*, 58 Cal. 550; *Wickersham v. Crittenden*, 106 Cal. 327, 39 Pac. 602; *Butts v. Wood*, 37 N. Y. 317, aff'g 38 Barb. 181; *Copeland v. Johnson Mfg. Co.*, 47 Hun (N. Y.) 235; *Purchase v. Atlantic Safe Deposit & Trust Co.*, 81 N. J. Eq. 344, 87 Atl. 444; *Atwater v. Elkhorn Valley Coal Land Co.*, 184 N. Y. App. Div. 253, 171 N. Y. Supp. 552; *Wonderful Group Min. Co. v. Rand*, 111 Wash. 557, 191 Pac. 631; *Ravenswood, S. & G. Ry. Co. v. Woodyard*, 46 W. Va. 558, 33 S. E. 285.

The mere fact that a director whose salary in another office was fixed by the directors was present at the meeting does not render the resolution invalid, where he did not vote (*Hax v. R. T. Davis Mill Co.*, 39 Mo. App. 453), unless his presence was necessary to constitute a quorum (*Bassett v. Fairchild*, 132 Cal. 637).

⁴³ *Cahall v. Lofland*, 12 Del. Ch. 299, 114 Atl. 224; s. c., 13 Del. Ch. 384, 118 Atl. 1.

⁴⁴ *Clark v. American Coal Co.*, 86 Iowa 436, 53 N. W. 291, 17 L. R. A. 557; *Wickersham v. Crittenden*, 110 Cal. 332, 42 Pac. 893; *McNab v. McNab & Harlin Mfg. Co.*, 62 Hun (N. Y.) 18, 16 N. Y. Supp. 448, aff'd 133 N. Y. 687, 31 N. E. 627.

⁴⁵ *Booth v. Beattie*, 95 N. J. Eq. 776, 118 Atl. 257, 123 Atl. 925.

⁴⁶ *Wickersham v. Crittenden*, 110 Cal. 332, 42 Pac. 893; *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818, L. R. A. 1915 D 632.

⁴⁷ *Russell v. Henry C. Patterson Co.*, 232 Pa. 113, 81 Atl. 136, 36 L. R. A. (N. S.) 199; *Martin v. Santa Cruz Water-Storage Co.*, 4 Ariz. 171, 36 Pac. 36. It is otherwise if the action of the directors was void. *Bassett v. Fairchild*, 132 Cal. 637, 64 Pac. 1082, 52 L. R. A. 611.

give relief by injunction or decree for an accounting at the suit of the corporation or of minority stockholders.⁴⁸

Compensation for past services.—When an officer is not impliedly entitled to compensation for services, a vote or other promise by the directors or stockholders to pay him therefor given after the services have been performed, is not only without consideration, and void as a promise on that ground, but is also *ultra vires*, as a misapplication of the corporate funds. And the same is true in any other case where services are rendered for a corporation without any express promise to pay for them, and under circumstances from which no promise will be implied, and a promise to pay is given after their performance.⁴⁹ This doctrine does not apply, however, where services are rendered with an understanding that compensation shall be paid, and under such circumstances as to raise an implied promise. In such a case, a note or other express promise to pay a reasonable sum then agreed upon is supported by a sufficient consideration.⁵⁰

⁴⁸ *Sellers v. Phoenix Iron Co.*, 13 Fed. 20; *Davis v. Memphis City Ry. Co.*, 22 Fed. 883; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Seitz v. Union Brass & M. Mfg. Co.*, 152 Minn. 460, 189 N. W. 586, 27 A. L. R. 293; *Copeland v. Johnson Mfg. Co.*, 47 Hun (N. Y.) 235; *Butts v. Wood*, 38 Barb. 181, 37 N. Y. 317; *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818, L. R. A. 1915 D 632; *Burns v. Beck*, 83 Ga. 471, 10 S. E. 121; *Decatur Mineral Land Co. v. Palm*, 113 Ala. 531, 21 So. 315, 59 Am. St. Rep. 140; *Schoening v. Schwenk*, 112 Iowa 733, 84 N. W. 916.

Stratis v. Andreson, 254 Mass. 536, 150 N. E. 832, 44 A. L. R. 567, 570n, on right of court to interfere with amount of salaries voted to officers of private corporations by directors. Directors cannot receive as salaries more than fair value of services; fairness is open to examination in equity.

⁴⁹ *Martindale v. Wilson-Cass Co.*, 134 Pa. St. 348, 19 Atl. 680, 19 Am.

St. Rep. 706; *Ellis v. Ward*, 137 Ill. 509, 25 N. E. 530; *Cheaney v. Lafayette, B. & M. R. Co.*, 68 Ill. 570, 18 Am. Rep. 584; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Beers v. New York Life Ins. Co.*, 66 Hun (N. Y.) 75, 20 N. Y. S. 788; *Taylor v. Ellsworth Bldg. Corp.*, — N. Y. Misc. —, 183 N. Y. Supp. 394; *Alexander v. Equitable Life Assur. Soc.*, 233 N. Y. 300, 135 N. E. 509; *State v. People's Mut. Benefit Ass'n*, 42 Ohio St. 579; *Wood v. Lost Lake & C. Mfg. Co.*, 23 Ore. 20, 23 Pac. 848, 37 Am. St. Rep. 651; *National Loan & Investment Co. v. Rockland Co.*, 94 Fed. 335; *Ravenswood, S. & G. Ry. Co. v. Woodyard*, 46 W. Va. 558, 33 S. E. 285.

⁵⁰ *National Loan & Investment Co. v. Rockland Co.*, 94 Fed. 335; *Stewart v. St. Louis, Ft. S. & W. R. Co.*, 41 Fed. 736; *St. Louis, Ft. S. & W. R. Co. v. Tiernan*, 37 Kan. 606, 15 Pac. 544.

CHAPTER XII.

CAPITAL STOCK AND ISSUE OF STOCK.

I. NATURE OF CAPITAL STOCK AND SHARES OF STOCK.

§ 128. In general.—The “capital stock” of a corporation is properly the amount subscribed and paid in or secured to be paid in by the shareholders, and upon which the corporation is to conduct its operations. It is the fund representing the original contributions of the stockholders to be permanently devoted to the business as contrasted with surplus available for dividends.

A share of the capital stock of a corporation is the interest or right which the owner has in the corporation,—the right to participate, according to his interest, in the management of the corporation, in its surplus profits on a division, and ultimately, on its dissolution, in the assets remaining after payment of its debts.

A certificate of stock is not the stock itself, but merely evidence of the rights of the person named therein as a stockholder.

In the absence of provision or agreement to the contrary, it is not necessary to constitute one a stockholder.

Shares of stock, although intangible, may be made the subject of an action of trover to recover damages for their conversion.

§ 129. “Capital stock,” “capital,” and “stock.”

The important term “capital stock,” properly speaking, signifies the amount subscribed and paid in or secured to be paid in by the shareholders of a corporation, either in money, or in property, labor, or services, in the organization of the corporation or afterwards, and upon which it is to conduct its operations, and does not mean, necessarily, the assets of the corporation.¹ “Capital stock”

¹ Christensen v. Eno, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429; Canfield v. Morristown Fire Ass'n, 23 N. J. Law 195; Burrall v. Bushwick R. Co., 75 N. Y. 211; Barry v. Merchants' Exchange Co., 1 Sandf. Ch. (N. Y.) 280; Commercial Fire Ins. Co. v. Board of Revenue Montgomery Co., 99 Ala. 1, 14 So. 490, 42

Am. St. Rep. 17; Tradesman Pub. Co. v. Knoxville Car Wheel Co., 95 Tenn. 634, 32 S. W. 1097, 31 L. R. A. 593, 49 Am. St. Rep. 943. See People ex rel. Union Trust Co. v. Coleman, 126 N. Y. 433, 27 N. E. 818, 12 L. R. A. 762; Dodge v. Ford Motor Co., 204 Mich. 459, 170 N. W. 668.

is unfortunately used to express different meanings. It may be used to designate the amount of par value stock or number of shares which a corporation is authorized to issue. Sometimes it is used to refer to all the actual property of the corporation, and sometimes more properly that part of the property which represents the contributions of the stockholders in payment for their shares. Sometimes it is used to refer to the shares which have been issued to the stockholders, to gross assets, to capital, to the authorized amount of capital, to capital paid in, or to the corporate net worth.² Much confusion and uncertainty arise from these variable meanings, which must be determined by reference to the context. The amount of the capital stock, authorized by the articles or certificate of association or incorporation, always remains the same, unless it is increased or reduced by or under legislative authority,³ however much the assets or capital of the corporation may be increased by accumulation of profits or enhancement in the value of property, or reduced by losses or decrease of values.⁴

The term "capital" applied to corporations is often used interchangeably with "capital stock," and both are frequently used to express the same thing,—the property and assets of the corporation,—but this is improper. The capital stock of a corporation, as

² *Armstrong v. Emmerson*, 300 Ill. 54, 132 N. E. 768, 18 A. L. R. 693; *Hood Rubber Co. v. Com.*, 238 Mass. 369, 131 N. E. 201 ("The words 'capital,' 'capital stock,' 'shares of capital stock' and 'stock' may be used as synonyms or with different meanings dependent upon the context in which they occur and the subject matter to which they are applied)."; *Peters Trust Co. v. Douglas Co.*, 106 Neb. 877, 184 N. W. 812; *People ex rel. Astoria Light, Heat & Power Co. v. Cantor*, 236 N. Y. 417, 141 N. E. 901, 30 A. L. R. 1458.

"Capital stock" sometimes refers to the sum fixed by the corporate charter as the amount paid or to be paid in by the stockholders for the prosecution of the business (1 *Cook, Corporations*, 38 n 2). But in statutes relating to taxation it may be construed to mean the actual property of the corporation invested in the business. *Hecht v. Malley*, 265 U. S. 144, 68 L. Ed. 949, 44 Sup. Ct. 462; *Ray Consol. Copper Co. v. United States*, 268 U. S. 373, 377,

69 L. Ed. 1003, 45 Sup. Ct. 526 (net assets); *People ex rel. Union Trust Co. v. Coleman*, 126 N. Y. 433, 439, 27 N. E. 818, 12 L. R. A. 762.

³ *Armstrong v. Emmerson*, 300 Ill. 54, 132 N. E. 768, 18 A. L. R. 693; *Fitzgerald v. Guaranty Security Corp.*, 239 Mass. 174, 131 N. E. 463. The Tenth Tentative Draft of a Uniform Business Corporation Act, § 1, X, defines "'capital stock' as (a) the aggregate amount of the par value of all allotted shares having a par value, including shares allotted as stock dividends, and (b) the aggregate of the cash and the value of any consideration other than cash, . . . agreed to be given or rendered as payment for all allotted shares having no par value, plus such amounts as may have been transferred from surplus upon the allotment of stock dividends in shares having no par value."

⁴ *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429; *Canfield v. Morristown Fire Ass'n*, 23 N. J. Law 195.

we have just seen, is the fund subscribed and paid in by the shareholders, or secured to be paid in, and upon which it is to conduct its operations. The term "capital," however, properly means, not the capital stock in this sense, but the actual property or estate of the corporation, whether in money or property.⁵

The term "stock" is sometimes used in the same sense as "capital stock."⁶ Ordinarily, however, it is used to designate, not the capital stock in the hands of the corporation, but the shares of the capital stock in the hands of the individual shareholders or stockholders, and this meaning should be given unless there is something to show a contrary intent.⁷

§ 130. Shares of stock.

A share of the capital stock of a corporation may be defined as the interest or right which the owner, who is called the "shareholder" or "stockholder," has in the management of the corporation, and in its surplus profits, and, on a dissolution, in all of its assets remaining after the payment of its debts,—the "right to participate, in a certain proportion, in the immunities and benefits of the corporation; to vote in the choice of their officers, and the management of their concerns; to share in the dividends of profits, and to receive an aliquot part of the proceeds of the capital, on winding up and terminating the active existence and operations of the corporation."⁸

It follows from the nature of a share of stock, that the owner thereof is not the owner nor entitled to the possession of any definite portion of the assets of the corporation. It is intangible,—a mere right to participate,—and is not capable of manual delivery. A person may be the owner of shares of the stock of a corporation,

⁵ *People v. Commissioners of Taxes & Assessments for City & County of New York*, 23 N. Y. 192, 219; *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429; *Canfield v. Morristown Fire Ass'n*, 23 N. J. Law 195.

The "capital" denotes the value of that which the corporation receives in return for its shares. "Authorized capital stock" indicates the number of shares which the corporation may issue of each class of stock, sometimes of a designated amount in par value, sometimes without par value.

⁶ See *People v. Commissioners of Taxes & Assessments for City & Coun-*

ty of New York, 23 N. Y. 192, 220; *Burr v. Wilcox*, 22 N. Y. 551.

⁷ *Lockwood v. Town of Weston*, 61 Conn. 211, 23 Atl. 9.

⁸ The term "shares" indicates the units of interest into which the rights of the proprietors of the corporate enterprise are divided. *United States Radiator Corporation v. State*, 208 N. Y. 144, 101 N. E. 783, 46 L. R. A. (N. S.) 585; *Fisher v. Essex Bank*, 5 Gray (Mass.) 373. And see *Oakbank Oil Co. v. Crum*, 8 App. Cas. 65; *Burrall v. Bushwick R. Co.*, 75 N. Y. 211; *Plimpton v. Bigelow*, 93 N. Y. 592; *Jones v. Concord & M. R. Co.*, 67 N. H. 234, 30 Atl. 614, 68 Am. St. Rep. 650; *Button v. Hoffman*, 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131.

and he may compel the corporation to deliver to him *evidence* of his right, but he cannot compel it to deliver to him the *shares*; and it follows that an action cannot be maintained for its refusal to do so.⁹ Since shares of stock are intangible and incapable of seizure and manual delivery, replevin will not lie to recover shares of stock, as distinguished from the certificate.¹⁰ The certificate of stock in a corporation is not the stock or share itself, but is mere evidence of the holder's rights as a stockholder.¹¹

Shares of stock in corporations are sometimes spoken of as "choses in action," and there are some cases in which they have been held to be choses in action.^{11a} They are somewhat in the nature of choses in action; but when we consider the rights of a shareholder and his relation to the corporation, it is clear that, strictly speaking, they are neither a chose in action nor a credit.¹²

The property of a corporation does not belong, in law, to the stockholders, but to the corporation as a distinct legal entity or artificial person, and the right of the stockholder is merely the right to participate in the management of the corporation, in any dividends which may be declared from profits, and ultimately in the distribution of what remains of its assets, on dissolution, after payment of its debts.^{12a}

§ 131. Certificates of stock.

It is usual for a corporation having a capital stock divided into shares to issue to its stockholders a certificate or certificates of stock, certifying or showing that the person named therein is the

⁹ *Burrall v. Bushwick R. Co.*, 75 N. Y. 211.

¹⁰ *Ashton v. Heydenfeldt*, 124 Cal. 14, 56 Pac. 624.

¹¹ *Richardson v. Shaw*, 209 U. S. 365, 52 L. Ed. 835, 28 Sup. Ct. 512, 14 Ann. Cas. 981; *Columbia Brewing Co. v. Miller*, 281 Fed. 289. See § 131, *infra*.

^{11a} *Colonial Bank v. Whinney*, 30 Ch. Div. 261 (Fry, L. J.), 11 App. Cas. 426. And see *Fisher v. Essex Bank*, 5 Gray (Mass.) 373; *Warren v. Davenport Fire Ins. Co.*, 31 Iowa 464; *Arnold v. Ruggles*, 1 R. I. 165; *Young v. South Tredegar Iron Co.*, 85 Tenn. 189, 2 S. W. 202, 4 Am. St. Rep. 752; *Yazoo & M. V. R. Co. v. City of Clarksdale*, 257 U. S. 10, 66 L. Ed. 104, 42 Sup. Ct. 27; *Young v. Garred*, 90 W. Va. 767, 112 S. E. 181, 23 A. L. R. 1317.

¹² *Bridgman v. City of Keokuk*, 72 Iowa 42, 33 N. W. 355; *Cates v. Baxter*, 97 Tenn. 443; *Smith v. Lingelbach*, 177 Wis. 170, 187 N. W. 1007.

It has been said that the issuance of a share of stock creates a personal relation analogous to that of partnership. *Longyear v. Hardman*, 219 Mass. 405, 106 N. E. 1012, Ann. Cas. 1916 D 1200; *Barret v. King*, 181 Mass. 476, 63 N. E. 934.

^{12a} *Macaura v. Northern Assur. Co., Ltd.*, [1925] S. C. 619 (shareholders have not even an insurable interest in corporate property. His interest is limited to a share in the profits and a share in the distribution of surplus assets when the corporation is wound up). But see 2 *Cambridge Law Journal*, p. 397; *Riggs v. Commercial Mut. Ins. Co.*, 125 N. Y. 7, 25 N. E. 1058, 10 L. R. A. 684, 21 Am. St. Rep. 716.

owner of the number of shares therein specified. It may also state the terms, or some of the terms, of the holder's contract with the corporation, the character of the stock, whether it is full-paid and nonassessable, the manner in which it must be transferred, whether it is transferable at all, etc. It is well settled, however, that a certificate of stock in a corporation is not the stock itself. It is the mere evidence of the holder's ownership of the stock and of his rights as a stockholder to the extent specified therein, just as a promissory note is merely the evidence of the debt secured thereby, and as title deeds are merely the evidence of the ownership of land.¹³

It necessarily follows that, in the absence of provision to the contrary, the issue of certificates of stock is not at all necessary, either to the existence of a corporation, or to make one a stockholder in such a corporation, for one may be a stockholder without the formal written evidence of his rights. In the absence of provision or agreement to the contrary, therefore, a subscriber for stock in a corporation, or, except as hereafter stated, a purchaser of stock, becomes a stockholder as soon as his subscription is accepted by the corporation, and statutory or charter conditions are performed or fulfilled, or as soon as the purchase is completed, as the case may be, whether any certificate of stock is issued to him or not; and as soon as he thus becomes a stockholder, although he may have no certificate, he is entitled to all the rights of a stockholder, including the right to dividends and the right to vote, etc., and is subject to all the liabilities of a stockholder, including liability to an action on his subscription, and liability to creditors in case of the corporation's insolvency.¹⁴ A certificate for shares is a document of title to the shares which symbolizes and represents

¹³ Winslow v. Fletcher, 53 Conn. 390, 4 Atl. 250, 55 Am. Rep. 122; Payne v. Elliot, 54 Cal. 339, 35 Am. Rep. 80; Atkins v. Garrett, 252 Fed. 280; United States Radiator Corporation v. State, 208 N. Y. 144, 101 N. E. 783, 46 L. R. A. (N. S.) 585. The term "issue of stock" as used in the cases does not involve an actual issuance of certificates, but signifies the recognition or acceptance of the subscriber as a stockholder in the corporation.

¹⁴ Chester Glass Co. v. Dewey, 16 Mass. 94, 8 Am. Dec. 128; Spear v. Crawford, 14 Wend. (N. Y.) 20, 28 Am. Dec. 513; Burr v. Wilcox, 22 N.

Y. 551; Webb v. Baltimore & Eastern Shore R. Co., 77 Md. 92, 26 Atl. 113, 39 Am. St. Rep. 396; Cartwright v. Dickinson, 88 Tenn. 476, 12 S. W. 1030, 7 L. R. A. 706, 17 Am. St. Rep. 910; California Southern Hotel Co. v. Callender, 94 Cal. 120, 29 Pac. 859, 28 Am. Rep. 99. This rule does not apply where a person or corporation sells shares of stock. In such a case the issue or tender of a certificate as evidence of the stock is a condition precedent to the right to maintain an action for the price. Marson v. Deither, 49 Minn. 423, 52 N. W. 38. See § 31, supra.

the rights of the holders, and passes much like an order, bill of lading, warehouse receipt, or other evidence of title which controls property and renders it more readily transferable.

§ 132. Conversion of shares of stock.

Because of the fact that shares of stock, although personal property, are intangible, it has been held in Pennsylvania that trover will not lie for the conversion of shares of stock, although it will lie for conversion of the certificate of stock which represents the shares.¹⁵ In other jurisdictions, however, it is the settled doctrine that shares of stock, since they are personal property, may be the subject of a conversion, notwithstanding their intangible nature, and that the action of trover will lie to recover damages for their conversion, the declaration or complaint alleging a conversion, not merely of the certificate of stock which is evidence of the stock, but of the stock itself.¹⁶ Any act of dominion wrongfully exerted over another's property, in denial of his right, or inconsistent with it, may be treated as a conversion; and this is just as true of shares of stock as it is of other property.¹⁷ And the conversion may be either by the corporation itself, or by some third person.

A corporation, as we shall hereafter see more at length, is guilty of a conversion of stock if it wrongfully sells or declares a forfeiture thereof for nonpayment of assessments, and afterwards refuses to recognize the owner as a stockholder,¹⁸ or if it wrongfully

¹⁵ Neiler & Warren v. Kelley, 69 Pa. St. 403, 407; Sewall v. Lancaster Bank, 17 Serg. & R. (Pa.) 285. But see Sparks v. Hurley, 208 Pa. 166, 57 Atl. 364, 101 Am. St. Rep. 926.

¹⁶ McAllister v. Kuhn, 96 U. S. 87, 24 L. Ed. 615; Anderson v. Nicholas, 28 N. Y. 600; Jarvis v. Rogers, 15 Mass. 389; Ayres v. French, 41 Conn. 142; Payne v. Elliot, 54 Cal. 339, 35 Am. Rep. 80; Sturges v. Keith, 57 Ill. 451, 11 Am. Rep. 28; Feige v. Burt, 118 Mich. 243, 77 N. W. 928, 74 Am. St. Rep. 390. See note, 21 A. L. R. 390.

¹⁷ Carpenter v. American Building & Loan Ass'n, 54 Minn. 403, 56 N. W. 95, 40 Am. St. Rep. 345; Mahaney v. Walsh, 16 N. Y. App. Div. 601, 44 N. Y. Supp. 969.

In order that conversion of a certificate of stock may constitute a con-

version of the stock which it represents, the owner must be thereby deprived of the stock, and not merely of the certificate. It has been held, therefore, that conversion of an unindorsed certificate of stock is not a conversion of the stock, and gives a right of action, not for the value of the stock, but for nominal damages only. Daggett v. Davis, 53 Mich. 35, 18 N. W. 548, 51 Am. Rep. 91; Pardee v. Nelson, 59 Utah 497, 205 Pac. 332, 21 A. L. R. 385.

¹⁸ Budd v. Multnomah St. Ry. Co., 15 Ore. 413, 15 Pac. 659, 3 Am. St. Rep. 169; Allen v. American Building & Loan Ass'n, 49 Minn. 544, 52 N. W. 144, 32 Am. St. Rep. 574; Herriek v. Humphrey Hardware Co., 73 Neb. 809, 103 N. W. 685, 119 Am. St. Rep. 917, 11 Ann. Cas. 201.

refuses to recognize and register a valid transfer, and issue a new certificate to the transferee.¹⁹

As was stated above, shares of stock may be converted by a third person, as well as by the corporation. Any wrongful use of a certificate of stock, bearing an executed assignment and power to transfer the same, so as to procure the title to be vested in a person not entitled, or otherwise deprive the owner of his property in the stock, may be treated as a conversion, and sued upon as such, notwithstanding the fact that the certificate is not the stock itself.²⁰ Shares of stock may be converted by a pledgee, as by selling the same without notice to the pledgor, or before maturity of the debt, or otherwise in violation of the rights of the pledgor.²¹ If the owner of shares recovers their value from the converter by judgment and execution, the defendant becomes the owner of the converted shares.²² The action of trover makes the converter an involuntary purchaser and the title passes to the judgment debtor upon payment.

II. AMOUNT OF CAPITAL STOCK, AND INCREASE OR REDUCTION THEREOF.

§ 133. In general.—A corporation cannot increase its capital stock beyond the amount originally fixed, even with the consent of all the stockholders, unless the power to do so is conferred upon it by the legislature. And when authority is so conferred, it must be exercised subject to the conditions, and in the mode, if any, prescribed by the statute or charter. An attempted increase without any authority is absolutely void; but where an increase is authorized, stockholders may be estopped to set up failure to comply with prescribed conditions or formalities.

¹⁹ *Bond v. Mt. Hope Iron Co.*, 99 Mass. 505, 97 Am. Dec. 49; *Craig v. Hesperia Land & Water Co.*, 113 Cal. 7, 45 Pac. 10, 35 L. R. A. 306, 54 Am. St. Rep. 316. See post, § 155.

²⁰ *McAllister v. Kuhn*, 96 U. S. 87, 24 L. Ed. 615; *Sturges v. Keith*, 57 Ill. 451, 11 Am. Rep. 28.

In *Hubbell v. Blandy*, 87 Mich. 209, 49 N. W. 502, 24 Am. St. Rep. 154, it was held that a gratuitous bailee of stock is liable for its conversion, if, without authority from the owner, he delivers the certificate to the officers of the corporation, who cancel it, and issue a new certificate to another

person, although he may have acted in good faith, and on a forged order.

²¹ *Feige v. Burt*, 118 Mich. 243, 77 N. W. 928, 74 Am. St. Rep. 390; *Wilson v. Little*, 2 N. Y. 443, 51 Am. Dec. 307; *Smith v. Savin*, 141 N. Y. 315, 36 N. E. 338. See *White v. Slayback*, 189 N. Y. App. Div. 564, 178 N. Y. Supp. 421.

²² *Boulter v. Joliet Nat. Bank*, 295 Ill. 594, 129 N. E. 513; *Bryan & Co. v. Scurlock*, 190 Iowa 534, 180 N. W. 684. See *Siegel v. Riverside Box Lumber Co.*, 89 N. J. Law 595, 99 Atl. 407.

When the capital stock of a corporation is increased under legislative authority, existing stockholders have the right, in preference to any other person and as between themselves, to subscribe for or purchase the new stock in proportion to the number of shares of the original stock held by them respectively, unless there is some statutory or charter provision or some agreement to the contrary, or unless they have waived the right. And this privilege may be sold or assigned by them.

A corporation cannot reduce the amount of its capital stock, directly or indirectly, without legislative authority.

When the number of shares into which the capital stock of a corporation is divided and their par value is fixed by the legislature, no change can be made therein without legislative authority. It is otherwise if they are not so fixed, and the change is so made as not to increase or reduce the amount of the capital stock.

§ 134. Increase and over-issue of stock.

When the charter of a corporation, or the general law under which it is formed, or its articles of association under authority thereby conferred, fixes the amount of its capital stock, the corporation is without the power to afterwards increase the same, directly or indirectly, even with the consent of all the stockholders, except in so far as the power to do so has been expressly or impliedly conferred upon it by the legislature; and any over-issue of stock is therefore void.²³

How and by whom the increase must be made or authorized, and effect of informalities, etc.—Since legislative authority is necessary to enable a corporation to increase its capital stock, the increase, as a rule, can only be accomplished *legally* in the mode and subject to the limitations, if any, prescribed by the legislature in authorizing the increase.²⁴ Informalities or irregularities, however, will not necessarily render the increase or subscriptions there-

²³ State v. Morristown Fire Ass'n, 23 N. J. Law 195; New York & N. H. R. Co. v. Schuyler, 34 N. Y. 30; Sutherland v. Olcott, 95 N. Y. 93; McNulta v. Corn Belt Bank, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203; Anthony v. Household Sewing-Machine Co., 16 R. I. 571, 18 Atl. 176, 5 L. R. A. 575. See Farmers' & Traders' Bank v. National Laun-

dry & Linen Supply Co., 30 Idaho 788, 168 Pac. 670.

²⁴ McNulta v. Corn Belt Bank, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203; Winters v. Armstrong, 37 Fed. 508; State v. McGrath, 86 Mo. 239; Jones v. Concord & M. R., 67 N. H. 119, 38 Atl. 120; s. c., 67 N. H. 234, 30 Atl. 614, 68 Am. St. Rep. 650.

for void. Failure to comply with provisions in the statute which are intended merely for the benefit and protection of the stockholders may be waived by them.²⁵

An increase of the capital stock of a corporation beyond the limit fixed by its charter or articles of association is so organic and fundamental a change that a general power to make the increase granted by the charter must be exercised by the stockholders, or with their consent. It cannot be exercised by the directors without the consent of the stockholders, unless it is expressly so provided.²⁶ Authority to increase the capital stock may be expressly conferred upon the directors of a corporation by its charter.²⁷

Effect of unauthorized increase or agreement therefor.—If a corporation undertakes to increase its capital stock without authority, and issues certificates for the additional stock, or if its officers or agents fraudulently issue certificates in excess of the amount authorized, the corporation, as we shall hereafter see, may be liable in damages to *bona fide* purchasers of the certificates.²⁸ The increase and the certificates, however, are void, because of the fact that it is beyond the power of the corporation to create and issue the additional stock, and the holders of the certificates, therefore, whether they be the original holders or their *bona fide* transferees, do not become stockholders,²⁹ except, under some circumstances, as to creditors.³⁰ It follows that, when an increase of the capital

²⁵ *Nelson v. Hubbard*, 96 Ala. 238, 11 So. 428, 17 L. R. A. 375; *Commissioner of Banks v. Cosmopolitan Trust Co.*, 253 Mass. 205, 148 N. E. 609; 39 Harvard Law Rev. 269. Failure to get a majority vote of stockholders for increase is no defense to statutory double liability of purchasers. See *Scott v. Deweese*, 181 U. S. 202, 45 L. Ed. 822, 21 Sup. Ct. 585; *Commissioner of Banks v. Tremont Trust Co.*, — Mass. —, 156 N. E. 7.

²⁶ *Chicago City Ry. Co. v. Allerton*, 18 Wall. (U. S.) 233, 21 L. Ed. 902; *Eidman v. Bowman*, 58 Ill. 444, 11 Am. Rep. 90; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203; *Humboldt Driving Park Ass'n v. Stevens*, 34 Neb. 528, 52 N. W. 568, 33 Am. St. Rep. 654.

²⁷ See *Sutherland v. Olcott*, 95 N. Y. 93.

²⁸ *New York & N. H. R. Co. v. Schuyler*, 34 N. Y. 30. See post,

§ 138. "Unauthorized shares" represent an attempt by the corporation to create additional shares when it has exhausted its authority to issue that class of shares.

²⁹ *New York & N. H. R. Co. v. Schuyler*, 34 N. Y. 30; *Seovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968. See *Kelly v. Central Union Fire Ins. Co.*, 101 Kan. 91, 165 Pac. 806, L. R. A. 1918 C 1170. See also, post, § 138.

³⁰ *Seovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *Kampman v. Tarver*, 87 Tex. 491, 29 S. W. 768; *Ross-Meehan Brake Shoe Foundry Co. v. Southern Malleable Iron Co.*, 72 Fed. 957; *Clark v. Turner*, 73 Ga. 1. Compare cases of irregularities and informalities in voting; holders may be estopped against creditors. In re *Miller's Dale & Ashwood Dale Lime Co.*, 31 Ch. Div. 211; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; *Scott v. Deweese*, 181 U. S. 202, 45 L. Ed. 822, 21 Sup.

stock of a corporation is unauthorized, the holders of certificates for the new stock cannot vote the same at corporate meetings. If they undertake to do so, the votes are void.³¹ And subscriptions for the new stock are absolutely void, both as between the corporation and the subscribers,³² and, subject to some limitation, even as against creditors.

§ 135. Rights and remedies of existing stockholders with respect to new stock.

As a general rule, when a corporation increases its capital stock under authority conferred by the legislature, stockholders at the time of the increase have the right, in preference to any other person, and as between themselves, to subscribe for or purchase the new stock in proportion to the number of shares of the original stock held by them respectively; and a majority of the stockholders or the officers of the corporation cannot lawfully deprive any stockholder of this right.³³ If a corporation decides to increase its capital stock by 20 per cent, the stockholders should be allowed to subscribe for an amount equal to 20 per cent of their holdings.

Ct. 585; *Veeder v. Mudgett*, 95 N. Y. 295; *Palmer v. Bank of Zumbrota*, 72 Minn. 266, 75 N. W. 380; *Latimer v. Bard*, 76 Fed. 536; *Hoefft v. Kock*, 123 Mich. 171, 81 N. W. 1070, 81 Am. St. Rep. 159.

³¹ *Humboldt Driving Park Ass'n v. Stevens*, 34 Neb. 528, 52 N. W. 568, 33 Am. St. Rep. 654.

³² *Cartwright v. Dickinson*, 88 Tenn. 476, 12 S. W. 1030, 7 L. R. A. 706, 17 Am. St. Rep. 910; *Kampman v. Tarver*, 87 Tex. 491; *Laredo Imp. Co. v. Stevenson*, 66 Fed. 633.

³³ When a corporation increases its capital stock each shareholder has a prior option to subscribe for a proportionate amount of the new issue to preserve his proportionate interest in assets and voting power. *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 78 N. E. 1090, 12 L. R. A. (N. S.) 969, 9 Ann. Cas. 738; *Miles v. Safe Deposit & Trust Co. of Baltimore*, 259 U. S. 247, 66 L. Ed. 923, 42 Sup. Ct. 483; *Glenn v. Kittanning Brewing Co.*, 259 Pa. St. 510, 103 Atl. 340, L. R. A. 1918 D 738, with note, Ann. Cas. 1918 D 769; 5 *Fletcher, Corporations*, sec. 3462; *Gray v. Portland Bank*, 3 Mass. 364, 3 Am. Dec. 156; *Jones v. Morrison*, 31 Minn. 140, 16

N. W. 854; *Eidman v. Bowman*, 58 Ill. 444, 11 Am. St. Rep. 90; *Humboldt Driving Park Ass'n v. Stevens*, 34 Neb. 528, 52 N. W. 568, 33 Am. St. Rep. 654; *Baltimore City Passenger Ry. Co. v. Hambleton*, 77 Md. 341, 26 Atl. 279; *Way v. American Grease Co.*, 60 N. J. Eq. 263, 47 Atl. 44; *Dousman v. Wisconsin & L. S. Mining & Smelting Co.*, 40 Wis. 418; *Gibbons v. Mahon*, 4 Mackey (D. C.) 130, 54 Am. Rep. 262, aff'd 136 U. S. 549, 34 L. Ed. 525, 10 Sup. Ct. 1057; *Hoyt v. Great American Ins. Co.*, 201 N. Y. App. Div. 352, 194 N. Y. Supp. 449; *Wall v. Utah Copper Co.*, 70 N. J. Eq. 17, 62 Atl. 533; *Kingston v. Home Life Ins. Co. of America*, 11 Del. Ch. 258, 101 Atl. 898; *Hammer v. Cash*, 172 Wis. 185, 173 N. W. 465. Right of stockholders to new stock, see *F. Dwight*, 18 Yale Law Journal 101. Stockholders' right of pre-emption, 20 Harvard Law Rev. 398; Preferred stockholders' right of pre-emption, 26 Harvard Law Rev. 75.

Compare with right of pre-emption, the right to sell a ratable share of his stock to the corporation purchasing stock for purpose of retirement or reduction. General Inv. Co.

This privilege of subscribing to a new issue of stock is termed a "right." The right has a value if the subscription price of the new stock is lower than the market price of the old stock.

The right of shareholders in a going concern to subscribe to new issues of stock flows from their claim to preserve their proportionate control or voting power and their proportionate interest in the surplus. Therefore stockholders who have no control and no interest in the surplus have no claim to subscribe to new issues. Such would be the case with nonvoting, nonparticipating preferred stock. It is generally held that preferred stockholders are entitled to a *pro rata* distribution of a new issue of common stock.^{33a} There are, however, various classes of shares, participating and nonparticipating shares, voting and nonvoting preferred or common shares, as to which the ground for the pre-emption right may be doubtful, since the basis is the protection of the interest of the stockholder in the corporate surplus and in his proportionate voting power. If the shareholder has no interest in the surplus, he should be required to pay the full actual value of the new shares if he wishes to protect his interest in the voting control.

The right of pre-emption, according to some courts, is limited to an increase of stock, and, in the absence of some express charter or statutory provision, a stockholder has no greater or different right than a stranger to subscribe for or purchase undisposed-of shares of the original stock.³⁴ Other courts, however, hold that the pre-emption right extends to original stock which is issued long after the creation of the corporation and the original issue of shares.³⁵ This seems supported by the weight of authority. The Wisconsin

v. American Hide & Leather Co., 98 N. J. Eq. 326, 129 Atl. 244; post, § 136.

^{33a} See post, sec. 142. Thomas Branch & Co. v. Riverside & Dan River Cotton Mills, 139 Va. 291, 123 S. E. 542. See 26 Harvard Law Rev. 75, 656; 13 Columbia Law Rev. 146. But see General Inv. Co. v. Bethlehem Steel Corp., 88 N. J. Eq. 237, 102 Atl. 252, where preferred stock had no right in assets except to extent of par and accrued dividends, and relative interest of the old preferred stock would not be affected by the issuance of new preferred stock without voting power holders need not be given right to subscribe. The reason for the right fails. Russell v. American Gas & Electric Co., 152 N. Y.

App. Div. 136, 136 N. Y. Supp. 602; Borg v. International Silver Co., 2 Fed. (2d) 910, noted in 20 Illinois Law Rev. 288.

³⁴ Archer v. Hesse, 164 N. Y. App. Div. 493, 150 N. Y. Supp. 296 (a corporation may dispose of its original, unissued authorized capital stock for any legitimate purpose and it is not obligated to give to existing stockholders an opportunity to purchase). See also, Curry v. Scott, 54 Pa. St. 270.

³⁵ Snelling v. Richard, 166 Fed. 635; Kingston v. Home Life Ins. Co. of America, 11 Del. Ch. 258, 101 Atl. 898; Bacon v. Groose, 165 Cal. 481, 132 Pac. 1027; Morris v. Stevens, 178 Pa. St. 563, 36 Atl. 151; Titus v. Paul State Bank, 32 Idaho 23, 179

court has said: ^{35a} "In an already established and going corporation an increase of capital stock, accomplished either by a formal increase of the amount originally authorized or by issue of what had originally been withheld, though within the authorized amount, without first giving opportunity to all existing stockholders to take their proportionate shares of such increase, is wholly beyond the power, not only of the directors, but of any mere majority of the stockholders." It is generally held, however, that the rule does not apply where a corporation has reacquired shares of its original stock by forfeiture for nonpayment of assessments, by compromise with stockholders, or by a valid purchase, and reissues the same. Such shares are assets of the corporation, and may be disposed of by it either to stockholders or to strangers, as it may deem best.³⁶

The purpose in the recognition of the pre-emptive right is to enable each shareholder to maintain the same proportionate degree

Pac. 514; *Thurmond v. Paragon Colliery Co.*, 82 W. Va. 49, 95 S. E. 816; 14 C. J. 394; *Fletcher, Corporations*, sec. 3479.

^{35a} Upon an increase of stock a stockholder is entitled to maintain his relative voice and influence in the control and management of the affairs of the company by purchasing an amount of the increase of the stock proportionate to his then holdings in the corporation. *Luther v. Luther Co.*, 118 Wis. 112, 94 N. W. 69, 99 Am. St. Rep. 977; *Dunn v. Acme A. & G. Co.*, 168 Wis. 128, 169 N. W. 297. This applies also to stock which has once been issued and then repurchased for the corporation and held in the treasury.

³⁶ *Borg v. International Silver Co.*, 11 Fed. (2d.) 143, 147; *State v. Smith*, 48 Vt. 266; *Crosby v. Stratton*, 17 Colo. App. 212, 68 Pac. 130. But see *Dunn v. Acme Auto & Garage Co.*, 168 Wis. 128, 169 N. W. 297; *Fletcher, Corporations*, secs. 3479, 3522.

In *Borg v. International Silver Co.*, 11 Fed. (2d.) 146, it is said: "We do not understand that they maintain that shareholders have a pre-emptive right in treasury shares. If so, the cases, of which there are not many, are against them (*Enright v. Heckscher*, 240 Fed. 863; *State v. Smith*, 48 Vt. 266; *Hartridge v. Rockwell*, R.

M. Charlt. [Ga.] 260; *Crosby v. Stratton*, 17 Colo. App. 212, 68 Pac. 130; *Cook on Corporations*, sec. 286), though the right is well settled when new shares are sold after an increase of capital stock (*Stokes v. Continental Trust Co.*, 186 N. Y. 285, 78 N. E. 1090, 12 L. R. A. [N. S.] 969, 9 Ann. Cas. 738; *Electric Co. of America v. Edison Elec. Illuminating Co.*, 200 Pa. St. 516, 50 Atl. 164; *Way v. American Grease Co.*, 60 N. J. Eq. 263, 269, 47 Atl. 44; *Gray v. Portland Bank*, 3 Mass. 364, 3 Am. Dec. 156).

"Holding, as I do, that the stock in question is old, fully paid stock, the stockholders have no right to insist that it be offered to them before being sold to the public. The rule that stockholders have the first right to subscribe to stock when issued applies only to new stock. *Wall v. Utah Copper Co.*, 70 N. J. Eq. 17, 62 Atl. 533; *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 78 N. E. 1090, 12 L. R. A. (N. S.) 969, 9 Ann. Cas. 738. And such stock may be sold for less than par. *Enright v. Heckscher*, 240 Fed. 863. The method of selling the stock to the highest bidder is admittedly not open to objection, if the stock is to be sold, and without first giving the stockholders the opportunity to buy it."

of voting power and corporate control, despite an increase in the corporation's stock, and also to preserve his interest in the corporate surplus, if any.³⁷ This last purpose could be accomplished by granting a remedy by injunction against an issue of additional shares at less than the reasonable saleable value thereof, where the effect would be to reduce the value of the share of the objecting shareholder.

The unissued stock of a corporation, and also treasury stock are held in trust for the stockholders in such a sense that it must be disposed of for the equal benefit of all. In disposing of it, the directors or majority of the stockholders cannot discriminate between the stockholders, or issue it to themselves, or to their nominees, either for the purpose of making a profit for themselves out of the transaction, or for the purpose of obtaining or retaining control of the corporation. If they attempt to do so, they commit a fraud upon the other stockholders, against which a court of equity will grant relief.³⁸

It is commonly said that new stock may be issued for property without first offering the right to subscribe to the existing stockholders.^{38a} This proposition, it would seem, may be subject to some question or qualification, as that the stock should be taken by the seller of the property, at its book value, if that is greater than the par value, or if the stock is without par value; and that the issue must not be made in bad faith as a device for getting control of the corporation.

A stockholder's right to a preference in subscribing for or purchasing the new stock, when the capital stock of a corporation is increased, may be sold or assigned by him.³⁹ If he is not so situated as to be able to take and pay for his proportionate share of

³⁷ See *Borg v. International Silver Co.*, 11 Fed. (2d) 143, 146, 150. See 36 *Yale Law Journal* 649, 659.

³⁸ *Reese v. Bank of Montgomery Co.*, 31 Pa. St. 78, 72 Am. Dec. 726; *Morris v. Stevens*, 178 Pa. St. 563, 36 Atl. 151; *Piercy v. S. Mills & Co., Ltd.*, [1920] 1 Ch. 77, 10 Brit. Rul. Cas. 11, 19, note, on legality of issue or sale of stock intended to enable directors to gain or retain control of company.

^{38a} *Meredith v. New Jersey Zinc & Iron Co.*, 55 N. J. Eq. 211, 37 Atl. 539, aff'd 56 N. J. Eq. 454, 41 Atl. 1116; *Wall v. Utah Copper Co.*, 70 N. J. Eq. 17, 30, 62 Atl. 533.

³⁹ *Miles v. Safe Deposit & Trust Co. of Baltimore*, 259 U. S. 247, 252, 66 L. Ed. 923, 42 Sup. Ct. 483 (stockholder's right to take his *pro rata* part of the new shares is analogous to a stock dividend); *Jones v. Concord & M. R. R.*, 67 N. H. 119, 38 Atl. 120; s. e., 67 N. H. 234, 30 Atl. 614, 68 Am. St. Rep. 650; *Atkins v. Albree*, 12 Allen (Mass.) 359; *Gerstenberg, Financial Organization and Management*, pp. 310-313. See also, *Van Slyke v. Norris*, 159 Minn. 63, 198 N. W. 409 (the mere holder of an option to purchase old stock or an executory contract to purchase does not possess the right).

the new stock, he is entitled to sell his right to anyone who can, and such rights are extensively traded in. A corporation may use the method of privileged subscriptions at par for new stock of greater intrinsic worth as a means of allowing the stockholders to participate in the corporate surplus after the manner of a stock dividend.^{39a} When shares of original stock are sold by the holder after an increase of the capital stock has been voted, the purchaser acquires, as an incident to the stock, the same right to a preference in subscribing for or purchasing the new stock as was possessed by the transferrer.⁴⁰

Gerstenberg gives the following illustration to show how the proportionate control of the old stockholders will be disturbed unless new stock, when about to be issued, is first offered to them: "Suppose A, B, and C own stock in the X company in the following proportion: 100 shares, 200 shares, 300 shares. If the directors issue 12 shares to D, a friend of C, the latter will control a clear majority, and if ordinary voting prevails, C may deprive A and B of representation on the board of directors. Under the rule of stockholders' rights to new issues, however, the 12 shares would have to be offered to A, B and C in proportion to their holdings, and A and B would have the right to maintain their proportionate control by taking 2 shares and 4 shares, respectively, leaving 6 for C."⁴¹

Gerstenberg illustrates the relation of new stock issues to the old stockholders' respective interests in the surplus with the aid of the following balance sheet:

A Company	
<i>Assets</i>	<i>Liabilities</i>
Total \$1,500,000	Stock \$1,000,000
	Debts 200,000
	Surplus 300,000

"The net value of the A company to its stockholders is the value of the assets less the amount of debts, that is, \$1,300,000. If we assume that the shares have a par value of \$100, then the book value of each share of the A company will be \$130. If \$2,000,000 of new stock is sold a par, the net value of the assets will be \$3,300,000 and the value of each share, therefore, will be \$110.

^{39a} *Miles v. Safe Deposit & Trust Co. of Baltimore*, 259 U. S. 247, 252, 66 L. Ed. 923, 42 Sup. Ct. 483, aff'd 273 Fed. 822.

⁴⁰ *Baltimore City Passenger Ry.*

Co. v. Hambleton, 77 Md. 341, 26 Atl. 279. See *Real Estate Trust Co. v. Bird*, 90 Md. 229, 44 Atl. 1048.

⁴¹ Gerstenberg, *Financial Organization and Management*, pp. 306-307.

In this case the new stockholders will get for \$100, a share worth \$110, and the old stockholders will see their shares diminish in value from \$130 to \$110 each. If, however, each old stockholder bought shares of new stock in proportion to his old holdings, he would get two new shares for each old one, since the stock of the company was increased by two shares for each old share. The \$20 loss suffered on the old stock would be made up by the \$10 gained on each of the two new shares. If the stock were sold at \$130 a share instead of at par, the old stockholders would not suffer even if they were not given an opportunity to subscribe to the new shares. But there would still be the question of unbalanced control explained in the previous section.”^{41a}

The articles or certificate of incorporation may contain provisions limiting or denying to the stockholders the pre-emptive right to subscribe to additional issues of stock. The certificate of incorporation of the Standard Oil Company of California, organized under the laws of Delaware, provides:

“The total number of shares authorized of the Corporation’s capital stock is fifteen million (15,000,000) and such shares are without nominal or par value.

“The shares of capital stock of this corporation, may be issued by this corporation from time to time for such consideration as from time to time may be fixed by the board of directors of this corporation; and all issued shares of the Capital Stock of this corporation shall be deemed fully paid and nonassessable and the holders of such shares shall not be liable thereunder to this Corporation or its creditors. No stockholder of this Corporation shall have any pre-emptive or preferential right of subscription to any shares of any stock of this Corporation, or to any obligations convertible into stock of this Corporation, issued or sold, nor any right of subscription to any thereof other than such, if any, as the Board of Directors of this Corporation in its discretion from time to time may determine, and at such price as the Board of Directors from time to time may fix, pursuant to the authority hereby conferred by the Certificate of Incorporation of this Corporation, and the Board of Directors may issue stock of this Corporation, or obligations convertible into stock, without offering such issue of stock, either in whole or in part to the stockholders of this Corporation. The acceptance of stock in this Corporation shall be a waiver of any such pre-emptive or preferential right which in the absence of

^{41a} Gerstenberg, *Financial Organization and Management*, p. 307.

this provision might otherwise be asserted by Stockholders of this Corporation or any of them.”

§ 136. Reduction of capital stock.

As a general rule, when the amount of the capital stock of a corporation is fixed by its charter or articles of association, or by the general law, it has no more power, in the absence of authority from the legislature, to reduce the same, either directly or indirectly, than it has to increase the same. Any change, to be valid, must be expressly authorized.⁴² A corporation cannot reduce its capital stock by purchasing its own shares for cancellation or retirement.⁴³ If it undertakes to do so, and pays for the shares out of the assets of the company, creditors of the company, on its becoming insolvent, may hold the stockholders liable in equity to the extent of the assets so received by them.⁴⁴ It has been held that a corporation cannot purchase its own shares for the purpose of holding them, on the ground that the purchase by a corporation of its own shares in effect reduces its capital stock to that extent until the shares are reissued.⁴⁵ Properly speaking, however, this is not in any sense a reduction of the *capital stock*.⁴⁶ The power of a corporation to purchase and hold its own shares is elsewhere considered.⁴⁷

It is within the power of the legislature to authorize a corporation to reduce the amount of its capital stock by a provision to that effect in its charter or the general law in force at the time it is organized, or by an amendment after its creation or organization. But a grant to a corporation of authority to increase its capital stock does not include the power to reduce the same.⁴⁸ A statute providing that a corporation, “at any meeting called for the purpose, may increase or reduce its capital stock and the number of

⁴² *Droitwich Patent Salt Co. v. Curzon*, L. R. 3 Exch. 35; *Seignouret v. Home Ins. Co.*, 24 Fed. 332; *Crandall v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560; *Cartwright v. Dickinson*, 88 Tenn. 476, 12 S. W. 1030, 7 L. R. 706, 17 Am. St. Rep. 910; *Star Pub. Co. v. Ball*, 192 Ind. 158, 134 N. E. 285. See note, 44 A. L. R. 11, 12 (reduction of capital stock); *Fletcher, Corporations*, secs. 3470, 1135.

⁴³ *Cartwright v. Dickinson*, 88 Tenn. 476, 12 S. W. 1030, 7 L. R. A. 706, 17 Am. St. Rep. 910; *Crandall v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560.

⁴⁴ *Crandall v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560; post, § 385.

⁴⁵ *Tulare Irrigation Dist. v. Kaweah Canal & Irrigation Co.*, 112 Cal. XVII, 44 Pac. 662. See *Trevor v. Whitworth*, L. R. 12 App. Cas. 409.

⁴⁶ *Allen v. Francisco Sugar Co.*, 193 Fed. 825; *Borg v. International Silver Co.*, 11 Fed. (2d) 147 (presumption is that stock purchased is not retired and may be resold).

⁴⁷ Ante, § 66.

⁴⁸ *Droitwich Patent Salt Co. v. Curzon*, L. R. 3 Exch. 35; *Seignouret v. Home Ins. Co.*, 24 Fed. 332; *Sutherland v. Olcott*, 95 N. Y. 93.

shares therein," does not authorize a corporation to reduce its capital stock by purchasing the shares of a particular stockholder, unless all consent. In order that such a reduction may operate justly to all the stockholders, each stockholder should be allowed to surrender such proportion of his stock as the amount of the proposed reduction bears to the whole amount of the capital stock.⁴⁹

In order that there may be a reduction of the capital stock of a corporation, action upon the part of the corporation to that end is necessary, and, as a rule, the special requirements of the statute, if any, must be substantially complied with.⁵⁰

Effect of purchase of shares by corporation.—When a corporation purchases shares of its own stock, as it may lawfully do under some circumstances, and as it may also do unlawfully,⁵¹ the shares are not thereby merged or extinguished, unless such is the intention. If it does not intend to retire the shares, they merely remain in suspension, and may be at any time reissued. This is true, whether the purchase of the shares was *intra vires* or *ultra vires*.⁵²

§ 137. Increase or reduction in number of shares and their par value.

Although there is no reduction or increase of a corporation's capital stock where the number of shares into which it is divided is changed, and a corresponding change is made in the par value of the shares,—as where the number of shares is doubled, and the par value of each share reduced one-half,—yet, if the charter of a corporation fixes the number and par value of its shares, such a change cannot be made without express authority from the legisla-

⁴⁹ General Inv. Co. v. American Hide & Leather Co., 98 N. J. Eq. 326, 129 Atl. 244, 44 A. L. R. 60 (a corporation in purchasing stock for retirement should acquire it ratably from each stockholder who desires to sell); Berger v. United States Steel Corp., 63 N. J. Eq. 506, 53 Atl. 14; Currier v. Lebanon Slate Co., 56 N. H. 262.

Nor can the stock be reduced, without the consent of all the stockholders, by allowing a particular stockholder to withdraw his subscription. Niagara Shoe Co. v. Tobey, 71 Ill. App. 250.

⁵⁰ Moses v. Ocoee Bank, 1 Lea (Tenn.) 398; Ferris v. Ludlow, 7

Ind. 517; Gade v. Forest Glen Brick & Tile Co., 165 Ill. 367, 46 N. E. 286. See Dominguez Land Corporation v. Daugherty, 196 Cal. 453, 238 Pac. 697, 44 A. L. R. 1, 11 note.

⁵¹ Ante, § 66.

⁵² Borg v. International Silver Co., 11 Fed. (2d) 147; City Bank of Columbus v. Bruce, 17 N. Y. 507; Hartridge v. Rockwell, R. M. Charl. (Ga.) 260; Western Imp. Co. v. Des Moines Nat. Bank, 103 Iowa 455, 72 N. W. 657; Williams v. Savage Mfg. Co., 3 Md. Ch. 418; Belknap v. Adams, 49 La. Ann. 1350, 22 So. 382. See ante, § 135, note 37.

ture.⁵³ There is nothing to prevent such a change, however, if the number and par value of the shares have not been so fixed, but have been left to be fixed by the corporation.⁵⁴ An increase or reduction in the number of shares without any change in the par value, or an increase or reduction in the par value without any change in the number, is an increase or reduction of the capital stock, as the case may be, and is invalid unless expressly authorized.⁵⁵ A change by amendment of the par value common stock to a number of shares twice as large without par value was held not an increase of the capital stock under the Massachusetts statute providing an excise fee for filing a certificate of an increase.⁵⁶

III. LIABILITIES ARISING FROM UNAUTHORIZED ISSUE OF CERTIFICATES.

§ 138. Liability of corporation.—An over-issue of stock is void, and the certificates thereof cannot make the holders stockholders. But a corporation is liable in damages to bona fide purchasers or pledgees of fictitious certificates of stock, if they were issued by an officer or agent under authority from the corporation or its managing officers, or by an officer or agent clothed with apparent authority, although his act may have been in fact unauthorized and fraudulent, or even a forgery; or if their issue, and the consequent injury, were the result of negligence on the part of the corporation or its managing officers.

As we have seen in a former section, a corporation is absolutely without the power to increase its capital stock beyond the amount fixed by its charter or the general law under which it was organized, or by its articles of association or incorporation, in pursuance thereof, unless such power has been conferred upon it by the legislature. It necessarily follows that certificates of stock issued by a corporation, which represent an over-issue of stock, are absolutely void, and cannot give the holders thereof the *status* of stock-

⁵³ *Droitwich Patent Salt Co. v. Curzon*, L. R. 3 Exch. 35; *Tschumi v. Hills*, 6 Kan. App. 549, 51 Pac. 619; *Salem Mill Dam Corp. v. Ropes*, 6 Pick. (Mass.) 23. See *Randle v. Winona Coal Co.*, 206 Ala. 254, 89 So. 790, 19 A. L. R. 118 (an amendment of a corporate charter, changing stock from stated to nonpar value, increasing the number of shares, and providing for preferred stock is valid if duly adopted by two-thirds vote in

compliance with statutory authority). See 44 A. L. R. 25 note.

⁵⁴ *Ambergate, Nottingham & B. & E. J. Ry. Co. v. Mitchell*, 4 Exch. 540; *Somerset & K. R. Co. v. Cushing*, 45 Me. 524.

⁵⁵ See *Droitwich Patent Salt Co. v. Curzon*, L. R. 3 Exch. 35.

⁵⁶ *Hood Rubber Co. v. Commonwealth*, 238 Mass. 369, 131 N. E. 201. Compare *Olympia Theatres v. Commonwealth*, 238 Mass. 374, 131 N. E. 204.

holders.⁵⁷ It does not follow, however, that the issue of fictitious and void certificates can impose no liability upon the corporation. It is a well-settled principle that a certificate of stock issued by a corporation having the power under its charter to issue certificates in the form in which the certificate is issued is a continuing affirmation or representation of the ownership of the amount of stock therein specified by the person named therein, or his assignee, and of his right to transfer the same, and that purchasers or pledgees have a right to rely on such affirmation, without inquiry as to the validity of the certificate, unless they have actual notice of its invalidity, or the circumstances are such as to create suspicion, and put a reasonably prudent man upon inquiry.⁵⁸

It is also a well-settled principle, in most jurisdictions, that a corporation is liable to the same extent and under the same circumstances as a natural person, for every fraud which it commits, and for negligence and other wrongs, however foreign to its nature or beyond its granted powers the wrongful transaction or act may be.⁵⁹ It follows from these principles that if a corporation itself, or an officer or agent for whose act it is responsible, fraudulently, or even by mistake and without any actual fraudulent intent, issues certificates of stock which are fictitious because they are in excess of its authorized capital stock, or otherwise unauthorized, it is liable in damages to *bona fide* purchasers or pledgees of such certificates who are deceived and injured by relying upon their genuineness. And in an action to recover damages, upon refusal of the corporation to recognize the validity of such a certificate, the corporation is estopped to set up as a defense that it had no power to create the stock or issue the certificate.⁶⁰

⁵⁷ New York & N. H. R. Co. v. Schuyler, 34 N. Y. 30; Smith v. Worcester & S. St. R. Co., 224 Mass. 564, 113 N. E. 462; Clark v. Turner, 73 Ga. 1. And see ante, § 134.

⁵⁸ Holbrook v. New Jersey Zinc Co., 57 N. Y. 616; In re Kisterbock's Appeal, 127 Pa. St. 601, 18 Atl. 381, 14 Am. St. Rep. 868; Joslyn v. St. Paul Distilling Co., 44 Minn. 183, 46 N. W. 337; First Ave. Land Co. v. Parker, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 841.

⁵⁹ New York & N. H. R. Co. v. Schuyler, 34 N. Y. 30. See ante, § 90.

⁶⁰ Shaw v. Port Philip & Colonial Gold Min. Co., 13 Q. B. Div. 103; Green v. Caribou Oil Min. Co., 179 Cal. 787, 178 Pac. 950; New York &

N. H. R. Co. v. Schuyler, 34 N. Y. 30; Holbrook v. New Jersey Zinc Co., 57 N. Y. 616; Fifth Ave. Bank v. Forty-Second Street & G. St. Ferry R. Co., 137 N. Y. 231, 33 N. E. 373, 19 L. R. A. 331, 33 Am. St. Rep. 712; Moores v. Citizens' Nat. Bank of Picqua, 111 U. S. 156, 28 L. Ed. 385, 4 Sup. Ct. 345; Allen v. South Boston R. Co., 150 Mass. 200, 22 N. E. 917, 5 L. R. A. 916, 15 Am. St. Rep. 185; Farrington v. South Boston R. Co., 150 Mass. 406, 23 N. E. 109, 5 L. R. A. 849, 15 Am. St. Rep. 222; Joslyn v. St. Paul Distilling Co., 44 Minn. 183, 46 N. W. 337. See First Ave. Land Co. v. Parker, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 841.

This principle also applies when a corporation, or an officer or agent for whose act it is responsible, recognizes as valid a forged or unauthorized transfer of stock, and issues a new certificate to the transferee, and the new certificate comes into the hands of a *bona fide* purchaser for value.⁶¹ And if a corporation transfers shares of stock on its books, and issues new certificates, leaving the original certificates outstanding, it will be liable to *bona fide* purchasers or pledgees of the stock who purchase or lend money on the same in reliance upon the original certificates.⁶²

§ 139. Authority of officer or agent issuing certificate, and the question of negligence.

Difficult questions have arisen in determining the liability of a corporation by reason of false certificates of stock, where the corporation has sought to escape liability on the ground that the certificates were issued by officers or agents without authority. The liability in such a case is to be determined by applying the general principles of the law of agency. There can be no question as to the liability of the corporation when the false certificates are issued by or in pursuance of the vote or consent of a majority of the stockholders, for the issue is then the direct act of the corporation. Nor can there be any doubt as to its liability where they are issued by or in pursuance of a vote or direction of the board of directors expressly or impliedly vested with the general authority to issue or authorize the issue of certificates of stock, or by other officers in whom such authority is vested. The liability is not so clear, however, when the certificates are issued by subordinate officers or agents without authority in fact from the stockholders or board of directors. It is a general principle that a corporation, like a natural person, is liable for acts, including fraud and other wrongs, done by its officers or agents in the course of their employment, and within either the real or the *apparent* scope of the powers delegated to them. If a particular act is within the apparent scope of the authority conferred upon an officer or agent of a corporation,

⁶¹ *Simm v. Anglo-American Telegraph Co.*, 5 Q. B. Div. 188; *Mandlebaum v. North American Min. Co.*, 4 Mich. 465; *Machinists' Nat. Bank v. Field*, 126 Mass. 345; *Fletcher, Corporations*, secs. 3491, 3492. And see post, § 151.

⁶² *Holbrook v. New Jersey Zinc Co.*, 57 N. Y. 616; *Joslyn v. St. Paul Distilling Co.*, 44 Minn. 183, 46 N. W. 337; *Bean v. American Loan & Trust Co.*, 122 N. Y. 622, 26 N. E. 11. And see post, § 150.

the corporation is liable therefor, although the act may have been in fact unauthorized, or even contrary to instructions.⁶³

It follows that a corporation is liable for the fraudulent or wrongful issue of false certificates of stock by an officer or agent whom it had clothed with general or apparent authority to issue certificates in the form in which the false certificates were issued, although the issue of the false certificates may have been unauthorized, and although they may have been issued by the officer or agent for his own purposes, and not for the purposes of the corporation.⁶⁴ "The ground of liability," said the Maryland court, "is not that the principal has been benefited by the act of the agent, but that an innocent third person has been damaged by confiding in the agent, who was accredited by the principal, as worthy of trust, in that particular business."⁶⁵

On the other hand, the corporation is not liable if the issue of the false certificates was not within either the actual or the apparent scope of the officer's or agent's authority, unless it has been guilty of negligence in the premises.⁶⁶

If certificates of stock are issued illegally, or by an officer fraudulently or without authority, and the circumstances are such that they are either void or voidable, the corporation may cancel the same, or a suit in equity to cancel the same and enjoin their transfer may be brought by the corporation, or, in a proper case, by a stockholder.^{66a}

Forged certificates.—Whether or not a corporation is liable to a *bona fide* purchaser of a false certificate of stock, where the officer or agent issuing the same forged the necessary signatures of the other officers, depends upon the circumstances. The proper rule in such a case is that the corporation is liable if the ability of the

⁶³ *Green v. Caribou Oil Min. Co.*, 179 Cal. 787, 178 Pac. 950.

⁶⁴ *New York & N. H. R. Co. v. Schuyler*, 34 N. Y. 30; *Tome v. Parkersburg Branch R. Co.*, 39 Md. 36, 17 Am. St. Rep. 540; and cases cited in the notes following.

⁶⁵ *Tome v. Parkersburg Branch R. Co.*, 39 Md. 36, 17 Am. Rep. 540.

⁶⁶ *Mechanics' Bank v. New York & N. H. R. Co.*, 13 N. Y. 599; *Manhattan Life Ins. Co. v. Forty-Second St. & G. St. Ferry R. Co.*, 64 Hun (N. Y.) 635, 19 N. Y. S. 90, aff'd 139 N. Y. 146, 34 N. E. 776; *Knox v. Eden*

Musee American Co., 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; *Moores v. Citizens' Nat. Bank of Piqua*, 111 U. S. 156, 28 L. Ed. 385, 4 Sup. Ct. 345.

^{66a} *New York & N. H. R. Co. v. Schuyler*, 34 N. Y. 30; *Wood v. Union Gospel Church Bldg. Ass'n*, 63 Wis. 9, 22 N. W. 75; *Bailey v. Champaign Mining & Prospecting Co.*, 77 Wis. 453, 46 N. W. 539; *Perry v. Tuskaloosa Cotton-Seed Oil-Mill Co.*, 93 Ala. 364, 9 So. 217; *Lilley v. Sterling Oil & Refining Co.*, 108 Kan. 686, 197 Pac. 201.

guilty officer to commit the forgery and fraudulently issue the certificate was due to the negligence of the corporation, and the failure of the purchaser or pledgee to discover the forgery was not due to any want of ordinary care on his part, or if the forgery was committed and the certificate issued by an officer intrusted with the duty of finally countersigning and issuing the certificate.⁶⁷ But the company is not liable where a necessary signature is forged by an officer who does not have the duty of issuing certificates.⁶⁸

Certificates signed in blank.—If a corporation or its managing officers intrust the officer or agent charged with the duty of registering transfers and issuing certificates with certificates of stock signed in blank by the officers by whom the by-laws require certificates to be signed, it will be liable if a certificate is fraudulently filled up and issued by such officer or agent, and comes into the hands of a *bona fide* purchaser or pledgee, not only on the ground of apparent authority, but also on the ground of negligence. Intrusting the officer or agent charged with the duty of issuing certificates with certificates signed in blank removes the safeguards against the fraudulent issue of false certificates intended by the by-laws,—the necessity for the approval and signature of the specified officers,—and is clearly negligence.⁶⁹

Stolen certificates.—It is a general principle that if a stock certificate is lost by the owner without negligence, or stolen, no title or right is acquired as against the owner either by the finder or thief or by a *bona fide* purchaser, and this principle applies where certificates are stolen from a corporation by one of its offi-

⁶⁷ Shaw v. Port Philip & Colonial Gold Min. Co., 13 Q. B. Div. 103; Tome v. Parkersburg Branch R. Co., 39 Md. 36, 17 Am. Rep. 540; Hill v. C. F. Jewett Publishing Co., 154 Mass. 172, 28 N. E. 142, 13 L. R. A. 193, 26 Am. St. Rep. 230; Fifth Ave. Bank v. Forty-Second St. & G. St. Ferry R. Co., 137 N. Y. 231, 33 N. E. 378, 19 L. R. A. 331, 33 Am. St. Rep. 712.

⁶⁸ Hill v. C. F. Jewett Publishing Co., 154 Mass. 172, 33 N. E. 378, 19 L. R. A. 331, 26 Am. St. Rep. 230; Manhattan Life Ins. Co. v. Forty-Second St. & G. St. Ferry R. Co., 139 N. Y. 146, 34 N. E. 776; Ehrich v. Guaranty Trust Co., 194 N. Y. App. Div. 658, 186 N. Y. Supp. 103 (the

mere act of the corporation in giving employee access to the certificate will not make it liable); Dollar Sav. Fund & Trust Co. v. Pittsburg Plate Glass Co., 213 Pa. 307, 62 Atl. 916, 5 Ann. Cas. 248.

⁶⁹ Allen v. South Boston R. Co., 150 Mass. 200, 22 N. E. 917, 5 L. R. A. 716, 15 Am. St. Rep. 185. See Cincinnati, N. O. & T. P. Ry. Co. v. Citizens' Nat. Bank, 56 Ohio St. 351, 47 N. E. 249, 43 L. R. A. 777. See also, Hudson Trust Co. v. American Linseed Co., 232 N. Y. 350, 134 N. E. 178; note 31 Yale Law Journal 773 (liability of corporation where stock certificate signed in blank by officers is stolen by employee).

cers or employees and fraudulently issued by him to a *bona fide* purchaser or pledgee. In such a case, if the officer or agent has no authority to issue certificates, and no negligence is imputable to the corporation, it is not liable to a *bona fide* purchaser of the certificates; and the mere fact that the officer or agent was intrusted with the custody of the certificates does not show negligence if the corporation had no reason to believe him to be untrustworthy.⁷⁰

Blue Sky Laws.—Statutes have been enacted in many states requiring a license or permit before issuing stock and other securities by public sale or subscription to guard against fraudulent issues. Most courts have held void a sale or issue of stock by a corporation which has not complied with the "Blue Sky Law," and the corporation cannot recover on the subscription contract.⁷¹ It would be a question of construction whether the stock would be void in the hands of a *bona fide* purchaser.

§ 139a. Persons who are entitled to relief.

The right of persons to hold a corporation liable because of the issue of fictitious certificates of stock is not based upon the stock which the certificates purport to represent, for, as we have seen, there is no such stock, but it is based upon the ground that *bona fide* purchasers or pledgees who have parted with their money in reliance upon the certificate being valid are entitled to be indemnified.⁷² And it follows that liability upon the part of the corporation exists only in favor of persons who have paid or advanced money on the faith of the fictitious certificates. The company is not liable to one who has taken such a certificate merely in payment of or as security for an antecedent debt, at least if no damages have been sustained by releasing or surrendering other

⁷⁰ *Knox v. Eden Musee American Co.*, 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700. See *Hudson Trust Co. v. American Linseed Co.*, 232 N. Y. 350, 134 N. E. 178, noted in 31 Yale Law Journal 773 (possession of certificates indorsed in blank was entrusted to the transfer agent and not to the clerk who assisted him and who merely had access to the certificates); *Fletcher, Corporations*, sec. 3489.

⁷¹ *Farm Products Co. v. Jordan*, 229 Mich. 235, 201 N. W. 198; *Reno v. American Ice Mach. Co.*, 72 Cal.

App. 409, 237 Pac. 784; *Biddle v. Smith*, 143 Tenn. 489, 256 S. W. 453. Compare *Warren People's Market Co. v. Corbett & Sons*, 114 Ohio St. 126, 151 N. E. 51, noted in 35 Yale Law Journal, 881, 882. See 14 California Law Rev. 101, 120. Post, § 283.

⁷² *In re Kisterbock's Appeal*, 127 Pa. St. 601, 18 Atl. 381, 14 Am. St. Rep. 868, 871, citing *Freeman v. Cooke*, 2 Exch. 654, and *In re Bahia & S. F. Ry. Co.*, L. R. 3 Q. B. 585. See *First Ave. Land Co. v. Parker*, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 841.

security, for such a person has expended nothing on the faith of the certificate.⁷³ Nor is it liable to a purchaser of the stock in reliance on the certificate, where he has not paid for it.⁷⁴

In all cases, the person seeking relief against the corporation must be in the position of a *bona fide* purchaser or pledgee. The corporation, therefore, is not liable to one who has purchased the certificate or loaned money upon it with actual knowledge of its invalidity, or with notice of facts which were sufficient to put a reasonably prudent man upon an inquiry or investigation which, if followed up with reasonable diligence, would have disclosed its invalidity.⁷⁵ When a person, in taking a certificate of stock from an officer of a corporation, whose duty it is to issue certificates, is dealing with the officer personally, as where the officer is selling the stock or pledging it for money loaned to himself, this fact is sufficient to put the person taking the certificate on inquiry, and, if he relies on the representations of the officer without making further and independent inquiry, he is guilty of such negligence as to exclude him from the position of a *bona fide* purchaser or pledgee.⁷⁶

Where a person to whom an application for a loan is made, and to whom a certificate of stock is offered as collateral security, applies at the office of the corporation to the person in charge thereof, and who is its secretary and treasurer, and inquires whether the certificate is genuine, and receives an answer in the affirmative, and then makes the loan and takes the certificate as collateral, he is entitled to protection as a *bona fide* holder, and he does not lose his

⁷³ *In re Kisterbock's Appeal*, 127 Pa. St. 601, 18 Atl. 381, 14 Am. St. Rep. 868.

⁷⁴ *Ryder v. Bushwick R. Co.*, 134 N. Y. 83, 31 N. E. 251.

⁷⁵ *Moore v. Citizens' Nat. Bank of Piqua*, 111 U. S. 156, 28 L. Ed. 385, 4 Sup. Ct. 345; *Farrington v. South Boston R. Co.*, 150 Mass. 406, 23 N. E. 109, 5 L. R. A. 200, 15 Am. St. Rep. 221; *Hudson Trust Co. v. American Linseed Co.*, 232 N. Y. 350, 134 N. E. 178.

⁷⁶ *Moore v. Citizens' Nat. Bank of Piqua*, 111 U. S. 156, 28 L. Ed. 385, 4 Sup. Ct. 345; *Farrington v. South Boston R. Co.*, 150 Mass. 406, 23 N. E. 109, 5 L. R. A. 849, 15 Am. St. Rep. 222. See also, *Wilson v. Metropolitan El. Ry. Co.*, 120 N. Y. 145, 24 N. E. 384, 17 Am. St. Rep. 625.

Where an officer of a corporation issues a false certificate of stock as security for money loaned to him personally, representing that he owns such an amount of stock, and that the stock has been transferred to the lender on the books of the corporation, as required by the by-laws printed on the certificate, the representations are made by him personally, and not as the agent of the corporation, and the corporation is not responsible therefor to the lender. *Moore v. Citizens' Nat. Bank of Piqua*, supra; *Farrington v. South Boston R. Co.*, supra. Compare *Cincinnati, N. O. & T. P. Ry. Co. v. Citizens' Nat. Bank*, 56 Ohio St. 351, 47 N. E. 249, 43 L. R. A. 777. See *Whitfield v. Nonpareil Consol. Copper Co.*, 67 Wash. 286, 123 Pac. 1078, 41 L. R. A. (N. S.) 187.

right to be so treated by selling the stock, and applying the proceeds to the payment of the loan, and afterwards, upon discovering that the certificate has been forged, taking an assignment thereof from the purchasers, and repaying them the amount paid by them at the sale.⁷⁷

§ 140. Lost certificates.—If a certificate of stock is lost or destroyed, the stockholder is entitled to a new certificate on giving a bond to indemnify the corporation against possible liability on the certificate alleged to be lost or destroyed, or, it seems, without giving indemnity, if it clearly appears that the certificate has in fact been destroyed, or actually stolen or lost, and in such condition that no liability can be incurred thereon.

A corporation may voluntarily issue, and in a proper case may be compelled to issue, a new certificate of stock in the place of an original certificate which has been stolen, destroyed, or otherwise lost by the owner. The issue of a new certificate in such a case is not an over-issue of stock.⁷⁸ Whether or not the corporation can require the owner of the lost certificate to give a bond to indemnify it against possible liability on the original certificate depends upon the circumstances. As we shall hereafter see, if a corporation issues a certificate of stock, it thereby represents that the person named therein is the owner of the number of shares designated therein, and that he has a right to transfer the same, and it will be estopped to deny this representation as against a *bona fide* transferee, at least to such an extent as to entitle him to recover damages.⁷⁹

It follows that if the owner of a certificate should transfer the same, and then, representing that it has been lost or stolen, induce or compel the corporation to issue to him a new certificate, and afterwards transfer it, the corporation would incur liability upon both certificates. It has accordingly been held that a corporation cannot be compelled to issue a new certificate in the place of one which is asserted to have been lost or stolen, unless a bond is given to indemnify it against liability to possible *bona fide* holders of the original certificate, at least without the clearest proof that it has in fact been lost or stolen, so that the corporation will not be liable to

⁷⁷ Fifth Ave. Bank v. Forty-Second St. & G. St. Ferry R. Co., 137 N. Y. 231, 33 N. E. 378, 19 L. R. A. 331, 33 Am. St. Rep. 712.

⁷⁸ Kinnan v. Forty-Second St. & St. N. Ave. Ry. Co., 1 N. Y. Misc.

457, 21 N. Y. Supp. 789, aff'd 140 N. Y. 183, 35 N. E. 498. See note on "right of stockholder to compel duplication of lost certificate," Ann. Cas. 1918 E 66.

⁷⁹ Post, § 138.

the holder.⁸⁰ The corporation, however, may be compelled to issue a new certificate if a bond of indemnity is given; and it has been held that it may be compelled to issue a new certificate without any indemnity, if there is clear proof that the original has been destroyed, or that it has been lost or stolen, not having an assignment thereon by the owner, or if the corporation is otherwise protected, for in such a case the corporation cannot incur any liability by reason of the original certificate.⁸¹ In some jurisdictions, provision is made by statute for the issue of a new certificate in the place of one lost or stolen, upon giving indemnity, or without indemnity, if the loss is clearly proved. The Uniform Stock Transfer Act, sec. 17, requires the giving of a bond with sufficient surety to be approved by the court.

IV. PREFERRED OR GUARANTEED STOCK.

§ 141. In general.—“Preferred stock,” as distinguished from “common stock,” entitles the holders to receive dividends out of surplus profits available for the payment of dividends, to the extent agreed upon, before any dividends are payable to the holders of common stock, and also, when it is so stipulated, to a preference over the holders of common stock on a distribution of capital.

Preferred stock makes the holders thereof stockholders, and not creditors; and, except as to the preference in the payment of dividends, gives them the same rights, and no greater, and subjects them to the same liabilities, as the holders of common stock. As against creditors, they have no greater rights than common stockholders, and the corporation cannot give them greater rights in the assets of the corporation as against creditors, unless by virtue of an express statutory provision.

The ordinary stock of a corporation, or “common stock,” as it is called, gives no stockholder any greater rights than any other stockholder. As the term implies, preferred stock gives the holder a preference over the holders of common stock with respect to the payment of dividends. Holders of preferred stock are entitled to

⁸⁰ Galveston City Co. v. Sibley, 56 Tex. 269; Guilford v. Western U. Tel. Co., 43 Minn. 434, 46 N. W. 70; s. c., 59 Minn. 332, 61 N. W. 324, 50 Am. St. Rep. 407; Butler v. Glen Cove Starch Mfg. Co., 18 Hun (N. Y.) 47; In re Francis, 7 Boyce (30 Del.) 388,

108 Atl. 31; Davis v. Lime Cola Bottling Works, 18 Ala. App. 562, 93 So. 323.

⁸¹ Guilford v. Western U. Tel. Co., 59 Minn. 332, 61 N. W. 324, 50 Am. St. Rep. 407; State v. New Orleans Gas Light Co., 25 La. Ann. 413.

receive dividends on their shares, to the extent agreed upon, before any dividends at all are paid to the holders of the common stock.⁸² The Supreme Court has remarked that: "In organizing corporations it is not unusual to issue different classes of securities with various priorities as between themselves, to represent different kinds of contribution to capital. In exchange for cash, bonds may be issued; for fixed properties, like plant and equipment, preferred stock may be given, while more speculative values, like good will or patent rights, may be represented by common stock."^{82a}

The expression "guaranteed stock" is sometimes used interchangeably with "preferred stock." Such stock is preferred stock,—stock upon which the payment of a certain dividend at specified periods is guaranteed before payment of any dividend to other stockholders. But the guaranty is not absolute, so as to create the relation of debtor and creditor between the corporation and the holders of such stock, irrespective of whether there are profits. It is a guaranty of the specified dividends out of profits available for the payment of dividends.⁸³ If, however, there are no profits out of which the dividend can be paid at any time when it is payable according to the terms of the guaranty, the dividend is not necessarily lost, but the holders of the stock will be entitled to payment of all arrears before any payments can be made to the holders of common stock.⁸⁴ In other words, it is "cumulative."

§ 142. Rights and remedies of preferred stockholders.

The rights of preferred stockholders are the same as those of common except as modified by statute or contract. The terms of the contract are generally set forth in the certificates of the preferred stock issued to the holders as evidence of their shares, but these are not the only evidence of the contract. They must be read in connection with the provisions of the charter or articles of association, the general law, the by-laws in force at the time the stock

⁸² *Henry v. Great Northern Ry. Co.*, 4 Kay & J. 1; *Kent v. Quicksilver Min. Co.*, 78 N. Y. 159; *Taft v. Hartford, P. & F. R. Co.*, 8 R. I. 310, 5 Am. Rep. 575. See post, § 161. See also, *Berle*, Participating preferred stock, 26 Columbia Law Rev. 303, as to different varieties of preferred stock.

^{82a} *La Belle Iron Works v. United States*, 256 U. S. 377, 65 L. Ed. 998, 41 Sup. Ct. 528.

⁸³ *Henry v. Great Northern Ry. Co.*, 4 Kay & J. 1, 1 De Gex & J. 606, 3 Jur. (N. S.) 1133; *Taft v. Hartford, P. & F. R. Co.*, 8 R. I. 310, 5 Am. Rep. 575; *Lockhart v. Van Alstyne*, 31 Mich. 76, 18 Am. Rep. 156. See 27 Columbia Law Rev. 587, 588.

⁸⁴ *Henry v. Great Northern Ry. Co.*, 4 Kay & J. 1, 1 De Gex & J. 606, 3 Jur. (N. S.) 1133; *Boardman v. Lake Shore & M. S. Ry. Co.*, 84 N. Y. 157.

was issued, and the vote or proceedings by or under which the stock was issued. All these enter into and form a part of the contract.⁸⁵ The contract between a corporation and the holders of its preferred stock cannot be changed, or their rights in any way impaired, without their consent, by any subsequent action of the corporation.⁸⁶ It may, however, be a doubtful question of statutory construction whether the statute as to amendments gives power to issue new classes of preferred stock and subordinate outstanding issues, making them secondary as to dividends by less than unanimous consent. Some courts have found that the power to change by amendment the relative rights and priorities of preferred stock was given by the statute in force at the time stock was issued.⁸⁷ Changes, of course, may be made with the unanimous consent, express or implied, of the preferred stockholders, just as any other contract may be changed by mutual consent of the parties, and, if a new arrangement is made by a majority of the stockholders, a preferred stockholder who accepts the benefit thereof impliedly consents.⁸⁸

Preferred stockholders as creditors.—It is no doubt safe to say that a corporation cannot, without express authority from the legislature, issue preferred stock which will give the holders the rights of stockholders, and also give them a claim for dividends or

⁸⁵ *Continental Ins. Co. v. Minneapolis, St. P. & S. S. M. Ry. Co.*, 290 Fed. 87, 31 A. L. R. 1320, 1326 n; *Belfast & Moosehead Lake R. Co. v. City of Belfast*, 77 Me. 445, 1 Atl. 362; *Heller v. National Marine Bank*, 89 Md. 602, 43 Atl. 800, 73 Am. St. Rep. 212; *Boardman v. Lake Shore & M. S. Ry. Co.*, 84 N. Y. 157; *Rogers v. New York & T. Land Co.*, 134 N. Y. 197, 32 N. E. 27; *Speare v. Rockland-Rockport Lime Co.*, 113 Me. 285, 93 Atl. 754, 6 A. L. R. 793. See note, the controlling effect of articles of incorporation over share certificates, 24 *Columbia Law Rev.* 177.

⁸⁶ See *Ashbury v. Watson*, 30 Ch. Div. 376; *Campbell v. American Zylonite Co.*, 122 N. Y. 455, 25 N. E. 853, 11 L. R. A. 596; *Pronick v. Spirits Distributing Co.*, 58 N. J. Eq. 97, 42 Atl. 586; *Hazeltine v. Belfast & Moosehead Lake R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330.

⁸⁷ *Peters v. United States Mortgage Co.*, 13 Del. Ch. 11, 114 Atl. 598; *Morris v. American Public Utilities*, 14 Del. Ch. 136, 122 Atl. 696; *Salt Lake Automobile Co. v. Keith-O'Brien Co.*, 45 Utah 218, 143 Pac. 1015; *General Inv. Co. v. American Hide & Leather Co.*, 98 N. J. Eq. 326, 129 Atl. 244. The issuing of cumulative prior preference stock carrying a dividend of 8 per cent and giving it precedence over existing preferred stock, both in payment of dividends and in the repayment of principal upon dissolution, may be authorized by amendment adopted by two-thirds of the stockholders, since the act authorizing such amendment is an integral part of the stockholder's contract. See 11 *Cornell Law Quarterly* 78.

⁸⁸ *Compton v. The Chelsea*, 59 Hun 624, 13 N. Y. Supp. 722, aff'd 128 N. Y. 537, 28 N. E. 662.

principal which will be superior to the right of creditors of the corporation to have its assets applied in payment of their claims. Such an arrangement, unless authorized by statute, would be contrary to public policy.⁸⁹ "The distinguishing feature of a bond is that it is an obligation to pay a fixed sum of money with stated interest. The distinguishing feature of stock is that it confers upon its holder a part ownership of the assets of the corporation and gives him a right to participate in the management of the corporation and to share in the surplus profits and on dissolution to share in the assets which remain after the debts are paid."⁹⁰

If authorized, however, a corporation may, in order to raise money, issue certificates in the form of certificates of preferred stock, so called, as security, making the holders creditors of the corporation, instead of mere stockholders, and even giving them a lien upon the property of the corporation, which will be superior to the rights of subsequent creditors or mortgagees.⁹¹

It has been said that a person cannot, by virtue of a certificate of preferred stock, be, at least as to the creditors of the corporation, both a stockholder and a creditor at the same time. And this is certainly true in the case of ordinary preferred stock.⁹² It may not be true, however, under particular statutory provisions. The legislature may expressly authorize the issue of stock which will give the holders the rights of creditors, and a lien on the property of the corporation which will have priority over the claims of subsequent creditors, and at the same time give them all the incidents, rights, privileges, and immunities, and subject them to all the liabilities,

⁸⁹ *Warren v. King*, 108 U. S. 389, 27 L. Ed. 769, 2 Sup. Ct. 789; *Hamlin v. Toledo, St. L. & K. C. R. Co.*, 78 Fed. 664, 36 L. R. A. 826; *Spencer v. Smith*, 201 Fed. 647; *Inscho v. Mid-Continent Development Co.*, 94 Kan. 370, 146 Pac. 1014, Ann. Cas. 1917 B 546; *Wright v. Johnston*, 183 Iowa 807, 167 N. W. 680; *Wilder v. Tax Com'r*, 234 Mass. 470, 125 N. E. 689; *Hewitt v. Linnhaven Orchard Co.*, 90 Ore. 1, 174 Pa. 616; *Kingston Cotton Mills v. Wachovia Bank & Trust Co.*, 185 N. C. 7, 115 S. E. 883, 29 A. L. R. 251, 254n.

⁹⁰ So-called "debenture bonds" held to be in fact preferred stock. *In re Fechheimer Fishel Co.*, 212 Fed. 357.

⁹¹ *Heller v. National Marine Bank*, 89 Md. 602, 43 Atl. 800, 45 L. R. A.

438, 73 Am. St. Rep. 212. And see *Savannah Real Estate, Loan & Building Co. v. Silverberg*, 108 Ga. 281, 32 S. E. 878; *Totten v. Tison*, 54 Ga. 139; *Burt v. Rattle*, 31 Ohio St. 116; *Gordon's Ex'rs v. Richmond, F. & P. R. Co.*, 78 Va. 501; *Fryer v. Wiedemann*, 148 Ky. 379, 146 S. W. 752, 39 L. R. A. (N. S.) 1011.

⁹² *Miller v. Ratterman*, 47 Ohio St. 141, 24 N. E. 496. And see *Hamlin v. Toledo, St. L. & K. C. R. Co.*, 78 Fed. 664, 36 L. R. A. 826; *Heller v. National Marine Bank*, 89 Md. 602, 43 Atl. 800, 45 L. R. A. 438, 73 Am. St. Rep. 212; *Booth v. Union Fibre Co.*, 142 Minn. 127, 171 N. W. 307 (agreement to redeem does not create relation of creditor); *Star Pub. Co. v. Ball*, 192 Ind. 158, 134 N. E. 285.

to which the ordinary stock of the corporation, or the holders thereof, are entitled or subject.⁹³ Conversely under the new Ohio Corporation Act bondholders may be given the voting rights of stockholders.

Rights with respect to dividends.—The holders of preferred stock are entitled to be paid dividends, in accordance with the terms of their contract, before any dividends can be paid to the holders of common stock.⁹⁴ The amount of the preference depends, of course, upon the terms upon which the stock is issued. Except as to this right of priority over common stock, preferred stock is subject, in so far as the payment of dividends is concerned, to substantially the same rules as common stock, unless they are rendered inapplicable by express provisions. Thus, dividends on ordinary preferred stock, like dividends on common stock, are payable, even when they are guaranteed, only when there are net earnings or surplus profits out of which dividends may properly be paid. If there are no such earnings or profits, preferred stockholders are not only not entitled to dividends, but it is a fraud upon creditors and illegal for the corporation to pay them.⁹⁵

The right of dividends on preferred stock, the remedies of preferred stockholders, whether dividends are cumulative, so as to entitle the holders to payment of arrears, and other questions, will be considered in a subsequent chapter in treating generally of dividends.⁹⁶ Preferred shares are exposed to the danger of intrusion of new securities with claims upon the earnings prior to their own.

Right to vote at corporate meetings.—In the absence of a charter or statutory provision or valid stipulation to the contrary, holders of preferred stock have the same right as holders of common stock to vote at stockholders' meetings.⁹⁷ And their contract may even give them the right to vote to the exclusion, for a time, of the holders of common stock, so as to place the management of

⁹³ *Heller v. National Marine Bank*, 89 Md. 602, 43 Atl. 800, 45 L. R. A. 438, 73 Am. St. Rep. 212.

⁹⁴ Post, § 161.

⁹⁵ *Hazel Atlas Glass Co. v. Van Dyk & Reeves, Inc.*, 8 Fed. (2d) 716; *Taft v. Hartford, P. & F. R. Co.*, 8 R. I. 310, 5 Am. Rep. 575; *Lockhart v. Van Alstyne*, 31 Mich. 76, 18 Am.

Rep. 156; *Field v. Lamson & Goodnow Mfg. Co.*, 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136; *Miller v. Ratterman*, 47 Ohio St. 141, 24 N. E. 496; post, § 161.

⁹⁶ Post, § 161.

⁹⁷ *Lockhart v. Van Alstyne*, 31 Mich. 76, 18 Am. Rep. 156.

the corporation entirely in their hands for the time specified.⁹⁸ On the other hand, it is within the power of a corporation, when it issues preferred stock, to provide expressly that it shall give no right to vote, and, when the certificates contain such a provision, it will be binding upon all persons who accept the same.⁹⁹ But in some states there are constitutional or statutory provisions which are construed to forbid the issue of preferred stock without equal voting rights.¹⁰⁰

The certificate of incorporation of the Tide Water Associated Oil Company, organized under the laws of Delaware, contains the following provisions as to preferred stock:

"6. So long as any of the preferred stock shall be outstanding, the corporation shall not mortgage any of its fixed assets or pledge any of the shares of stock owned by it in any affiliated company or any subsidiary company (said term subsidiary company to include any company in which the corporation owns a majority of the issued voting stock), unless authorized so to mortgage or pledge by vote or written consent of the holders of two-thirds in amount of the preferred stock then outstanding; but this provision shall not apply to purchase money mortgages or property acquired subject to mortgage.

"7. The preferred stock may be redeemed in whole or in part on any quarterly dividend payment date, at the option of the board of directors upon not less than sixty days' prior notice to the holders of record of the preferred stock, published, mailed and given in such manner and form and on such other terms and conditions as may be prescribed by the by-laws or by resolution of the board of directors, by payment in cash for each share of the preferred stock to be redeemed of one hundred and five per centum (105%) of the par amount thereof and in addition thereto all unpaid dividends accrued on such share. If less than all the out-

⁹⁸ *Mackintosh v. Flint & P. M. R. Co.*, 32 Fed. 350; s. c., 34 Fed. 582. See also, *In re Sharood Shoe Corp.*, 192 Fed. 945; *General Inv. Co. v. Bethlehem Steel Corp.*, 87 N. J. Eq. 234, 100 Atl. 347.

⁹⁹ *Miller v. Ratterman*, 47 Ohio St. 141, 24 N. E. 496; *Hamlin v. Toledo, St. L. & K. C. R. Co.*, 78 Fed. 664, 26 L. R. A. 826; *In re Barrow Haematite Steel Co.*, 39 Ch. Div. 582; *State ex rel. Frank v. Swanger*, 190 Mo. 561, 89 S. W. 872, 2 L. R. A. (N. S.) 121, 4 Ann. Cas. 563; *People ex*

rel. Browne v. Koenig, 133 N. Y. App. Div. 756, 118 N. Y. Supp. 136; *General Inv. Co. v. Bethlehem Steel Co.*, 87 N. J. Eq. 234, 100 Atl. 347.

¹⁰⁰ *People v. Emmerson*, 302 Ill. 300, 134 N. E. 707, 21 A. L. R. 636; *Film Producers v. Jordan*, 171 Cal. 664, 154 Pac. 605, L. R. A. 1916 D 903. See *Del Monte Light & Power Co. v. Jordan*, 196 Cal. 488, 238 Pac. 710; *Brooks v. State ex rel. Richards*, 3 Boyce (Del.) 1, 79 Atl. 790, 51 L. R. A. (N. S.) 1126, Ann. Cas. 1915 A 1133.

standing shares are to be redeemed, such redemption may be made by lot or *pro rata* as may be prescribed by resolution of the board of directors. From and after the date fixed in any such notice as the date of redemption (unless default shall be made by the corporation in the payment of the redemption price), all dividends on the preferred stock thereby called for redemption shall cease to accrue and all rights of the holders thereof as stockholders of the corporation, except the right to receive the redemption price, shall cease and determine. Any purchase by the corporation of shares of its preferred stock shall not be made at prices in excess of said redemption price.

“8. Except as otherwise required by the statutes of the state of Delaware and as herein otherwise provided, the holders of the common stock shall exclusively possess voting power for the election of directors and for all other purposes, and the holders of the preferred stock shall have no voting power; provided, however, that in case the corporation shall be in default in respect to the declaration and payment of full regular quarterly dividends on the preferred stock for four quarterly dividend periods, then and in every such case the holders of the preferred stock, until such default shall have been cured by the payment of dividends, shall have the right to vote at all meetings of stockholders for the election of directors and for all other purposes; but if all such accrued unpaid dividends shall be paid by the corporation at any time, then and thereupon all power of the holders of the preferred stock to vote as in this paragraph provided shall cease, subject, however, to being again revived upon any such subsequent failure of the corporation in respect of four quarterly dividend periods to declare and pay the full dividend on the preferred stock. The holders of the preferred stock shall not be entitled to notice of any meeting of stockholders, except when they shall have the right to vote thereat as herein provided.”

Rights on distribution of assets on insolvency or dissolution.—

When the assets of a corporation are distributed among its stockholders, not by way of dividend, but on a dissolution and winding up, the holders of preferred stock have the same, and no greater, right to share in the assets as the holders of common stock,¹⁰¹ un-

¹⁰¹ *Lloyd v. Pennsylvania Elec. Vehicle Co.*, 75 N. J. Eq. 263, 72 Atl. 16, 21 L. R. A. (N. S.) 228, 138 Am. St. Rep. 557. 20 Ann. Cas. 119, rev'g

Hellman v. Pennsylvania Elec. Vehicle Co., 73 N. J. Eq. 269, 67 Atl. 834; *Jones v. Concord & M. R. R.*, 67 N. H. 119, 234, 38 Atl. 120, 68 Am.

less, by statute or by their agreement with the corporation, they are given a preference, not only in the payment of dividends, but also in the distribution of capital;¹⁰² otherwise they are on an equal footing with common stockholders.

Since the holders of ordinary preferred stock are stockholders, and not creditors of the corporation, they are not entitled, any more than the holders of common stock, to receive any portion of the assets of the corporation, on its insolvency or dissolution, until the creditors of the corporation are fully paid.¹⁰³ As we have seen, however, the holders of preferred stock, so called, may be given a prior lien by or under express statutory provision.¹⁰⁴ And when a dividend upon preferred stock has been lawfully declared out of profits, but not paid, the holders have the rights of creditors, as distinguished from stockholders, to the extent of such dividend.¹⁰⁵ But preferred stockholders on dissolution of the corporation and sale of its assets were held not entitled after payment of the par value of their stock to arrears of cumulative dividends before distribution of the balance among the common stockholders. This was so decided on the ground that there had been no profits from which they could be declared, and the amount remaining was not sufficient to pay the par value of the common stock.¹⁰⁶

Rights on increase or reduction of capital stock.—When a corporation increases its capital stock, holders of preferred stock have the same privilege as holders of common stock to subscribe for or purchase a proportionate amount of the new stock, unless there is some provision to the contrary in their contract; and it makes no difference that the amount of dividends is limited.¹⁰⁷ In like man-

St. Rep. 650; *Birch v. Cropper*, 14 App. Cas. 525; *Drewry, Hughes Co. v. Throckmorton*, 120 Va. 859, 92 S. E. 818; *Continental Ins. Co. v. United States*, 259 U. S. 156, 181, 66 L. Ed. 871, 42 Sup. Ct. 548.

¹⁰² *Hamlin v. Toledo, St. L. & K. C. R. Co.*, 78 Fed. 664, 36 L. R. A. 826; *Heller v. National Marine Bank*, 89 Md. 602, 43 Atl. 800, 45 L. R. A. 438, 73 Am. St. Rep. 212; *McGregor v. Home Ins. Co. of Newark*, 33 N. J. Eq. 181; *Miller v. Rateman*, 47 Ohio St. 141, 24 N. E. 496; *Petry v. Harwood Elec. Co.*, 280 Pa. 142, 124 Atl. 302, 33 A. L. R. 1249, 1257 n.

¹⁰³ *Kinston Cotton Mills v. Wachovia Bank & Trust Co.*, 185 N. C. 7, 115 S. E. 883, 29 A. L. R. 251, 254 n;

Heller v. National Marine Bank, 89 Md. 602, 43 Atl. 800, 45 L. R. A. 438, 73 Am. St. Rep. 212, *McSherry, C. J.* See also, *Hamlin v. Toledo, St. L. & K. C. R. Co.*, 78 Fed. 664, 36 L. R. A. 826; *Armstrong v. Union Trust & Savings Bank*, 248 Fed. 268.

¹⁰⁴ *Heller v. National Marine Bank*, 89 Md. 602, 43 Atl. 800, 45 L. R. A. 438, 73 Am. St. Rep. 212. And see *supra*, this section; also 29 A. L. R. 266 n.

¹⁰⁵ See post, § 157.

¹⁰⁶ *Michael v. Cayey-Caguas Tobacco Co.*, 190 N. Y. App. Div. 618, 180 N. Y. Supp. 532.

¹⁰⁷ *Jones v. Concord & M. R. R.*, 67 N. H. 119, 234, 38 Atl. 120, 68 Am. St. Rep. 650. See ante, § 135.

ner, on a reduction of the capital stock because of losses, preferred stock must be reduced proportionately with common stock, unless there is some special provision in the statute or contract of the parties fixing a different rule.¹⁰⁸ This rule does not apply where the stock is preferred, not merely as to dividends, but also as to capital.¹⁰⁹ In such a case the common stock must first be exhausted before the preferred can be compelled to contribute.

§ 143. Liabilities of preferred stockholders.

In the absence of express provision to the contrary, the holders of preferred stock in a corporation are subject to the same liabilities as the holders of the common stock. Thus they are liable on the same principles upon their subscriptions for shares. And creditors, if the corporation becomes insolvent, may in equity compel subscribers to pay the full amount of their subscriptions, irrespective of any secret agreements with the corporation.¹¹⁰ So, where a statute makes the stockholders of a corporation individually liable to creditors beyond the par value of their shares, it applies to the holders of preferred stock.¹¹¹

§ 144. Bonds, convertible into stock, and stock convertible into bonds.—When a corporation issues stock convertible into bonds, or bonds convertible into stock, etc., at the option of the holder, the rights of the holder are determined by the terms of the contract. He must exercise the option within the time, if any, specified, or, if no time is specified, within a reasonable time.

A holder of notes or bonds convertible into stock is not a stockholder, nor entitled to rights as such, until he has exercised the option and received the stock.

But see *Borg v. International Silver Co.*, 2 Fed. (2d) 910, noted in 20 Ill. Law Rev. 288, where right of common and preferred to share in the surplus is involved in new issue of stock; *Russell v. American Gas & Electric Co.*, 152 N. Y. App. Div. 136, 136 N. Y. Supp. 602; 26 Harvard Law Rev. 75; 13 Columbia Law Rev. 146.

¹⁰⁸ *In re Gatling Gun*, 43 Ch. Div. 628; *Page v. American & British Mfg. Co.*, 129 N. Y. App. Div. 346, 113 N. Y. Supp. 734; *General Inv. Co. v. American Hide & Leather Co.*, 98 N. J. Eq. 326, 129 Atl. 244, 246, 44 A. L. R. 60 (it is held that in

the purchase of preferred stock for retirement, it should be acquired ratably from each stockholder who desires to sell). See note, 44 A. L. R. 25, 35, requirement that reduction must be ratable.

¹⁰⁹ *In re Quebrada Railway, Land & Copper Co.*, 40 Ch. Div. 363; *In re London & New York Inv. Corp.* [1895] 2 Ch. 860; *Page v. Whittenton Mfg. Co.*, 211 Mass. 424, 97 N. E. 1006. See 33 A. L. R. 1266n.

¹¹⁰ See post, § 199 et seq.

¹¹¹ *Railroad Co. v. Smith*, 48 Ohio St. 219, 31 N. E. 743. See California Civ. Code, sec. 290, subd. 6.

A corporation is sometimes authorized to issue bonds or notes convertible into stock at the option of the holder, or to issue stock convertible into bonds. And to some extent, no doubt, such power may be implied in the absence of express provision therefor. A grant of such power carries with it by implication the power to do everything necessary to enable the corporation to exercise it. Thus, if a corporation is authorized to issue bonds convertible into stock at the option of the holder, it is impliedly given the power to increase the amount of its capital stock to such an extent as may be necessary to make the exchange.¹¹² If a bond is convertible into stock at the option of the holder, without any restriction as to time, he may exercise the option and demand the stock at any time within a reasonable time, and, if he exercises the option and receives or demands the stock just before the declaration of a dividend, he will be entitled to the dividend, when declared, as well as the stock.¹¹³

Persons holding bonds or notes of a corporation convertible into stock at their option are not in the position of stockholders, either at law or in equity, nor are they entitled to the rights of stockholders, until they have exercised the option and received the stock, or, at least, until the time fixed for exercise of the option, and a demand, but are merely creditors.¹¹⁴ It has been held, therefore, that until then they are not entitled to a stockholder's right of preference in subscribing for or purchasing new stock on an increase of the capital stock of the corporation.¹¹⁵

¹¹² *Belmont v. Erie Ry. Co.*, 52 Barb. (N. Y.) 637.

¹¹³ *Jones v. Terre Haute & Richmond R. Co.*, 57 N. Y. 196.

¹¹⁴ *Pratt v. American Bell Tel. Co.*, 141 Mass. 225, 5 N. E. 307, 55 Am. Rep. 465. See A. A. Berle, Jr., con-

vertible bonds and stock purchase warrants, 36 Yale Law Journal 649.

¹¹⁵ *Pratt v. American Bell Tel. Co.*, 141 Mass. 225, 5 N. E. 307, 55 Am. Rep. 465. See A. A. Berle Jr., Convertible bonds and stock purchase warrants, 36 Yale Law Journal 649.

CHAPTER XIII.

TRANSFER OF SHARES.

§ 145. Restrictions on the transfer shares.—The right to transfer shares may be restricted or regulated by express charter or statutory provision, or by a valid by-law, but a by-law not expressly authorized, if it imposes unreasonable restrictions upon the transfer of shares, is void.

The right to transfer shares may be restricted by agreement between the corporation and the stockholders.

Restrictions in the charter or general law.—Restrictions upon the power to transfer shares of stock are sometimes imposed by provisions in the charter of a corporation or the general law. Such provisions, of course, are binding upon all persons who become stockholders after enactment of the statute. And they are binding upon purchasers of stock, for they are chargeable with notice. Transfers of stock may thus be prohibited altogether, so as to make the shares nontransferable, or they may be merely regulated by provisions requiring them to be made in a certain way.¹

¹ Merrill v. Call, 15 Me. 428; Sweetland v. Quidnick Co., 11 R. I. 328; Fisher v. Essex Bank, 5 Gray (Mass.) 373; Hassel v. Pohle, 214 N. Y. App. Div. 654, 212 N. Y. Supp. 561; Bloomingdale v. Bloomingdale, 107 N. Y. Misc. 646, 177 N. Y. Supp. 873; Farmers' Mercantile & Supply Co. v. Laun, 146 Wis. 252, 131 N. W. 366; Wright v. Iredell Tel. Co., 182 N. C. 308, 108 S. E. 744. Compare Prindiville v. Johnson & Higgins, 92 N. J. Eq. 515, 113 Atl. 915.

By Farmers' Mercantile & Supply Co. v. Laun, *supra*, it is held that while absolute restraints on the transfer of stock are invalid as against public policy, a provision in the contract of subscription, articles of incorporation, by-laws and certificates of shares that shares shall not be transferable without giving the out-

standing shares the option to consent to the transfer or take up the shares at par is valid.

In Bloomingdale v. Bloomingdale, *supra*, it is said: "A single share of the stock of any one of the corporations passing into hostile possession places in the hands of the possessor unlimited opportunity to harm and harass the management. The business is strictly private, and carried on in competition with other similar establishments. The inviolability of its business privacy and commercial secrets would be no longer safe from its aggressive rivals if the stock might be transferred in disregard of the prohibitions mentioned. . . . I have sought diligently, but without success, for a case impeaching the legality of reasonable restrictions upon the transfer of the stock

By-laws restricting or regulating transfers.—A corporation may undoubtedly enact such by-laws regulating the transfer of its shares as may be reasonably necessary to protect itself against colorable or fraudulent transfers, or to enable it to know who are its stockholders, and, as such, entitled to receive dividends, vote at corporate meetings, etc., or to enable purchasers of shares to ascertain at any time who are stockholders. Such regulations as are necessary for these purposes have repeatedly been upheld.²

It is well settled, however, that a corporation has no power to prohibit transfers to *bona fide* and responsible purchasers, or to directly or indirectly make the validity of such a transfer dependent upon the approval and consent of the directors. Such a by-law is void, not only because it violates the right of the stockholders, when they do not consent, but also because it is contrary to public policy as an unreasonable restraint upon the alienation of property.³ A few courts have held invalid a by-law providing that if any stockholder desires to dispose of his stock he must, before transfer, notify the officers of the corporation of his intention to sell, and that the corporation or the other stockholders shall have the option to purchase the shares.⁴

An agreement between a stockholder and the corporation giving the latter an option to purchase his shares before he sells them to

of a corporation where they are imposed by the charter, articles of association, or certificate of incorporation, and notice of the restrictions is stamped on the certificate of stock. All the decisions point in the other direction. . . . The Supreme Court of Wisconsin (Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N. W. 754, 150 N. W. 1101) declared valid a provision in the articles of incorporation of a company requiring that before the transfer of stock the stockholder must first offer it for sale to the board of directors."

² *Planters' & Merchants' Mut. Ins. Co. v. Selma Sav. Bank*, 63 Ala. 585; *Dane v. Young*, 61 Me. 160.

³ By-law is invalid making the validity of a transfer dependent upon the consent or approval of the directors of the corporation (*Farmers' & Merchants' Bank of Lineville v. Wasson*, 48 Iowa 336, 30 Am. Rep. 398; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 447, 45 N. E. 954, 56 Am. St.

Rep. 203, 210), or upon the assent of all or a certain proportion of the stockholders (*In re Klaus*, 67 Wis. 401, 29 N. W. 582); *Johnson v. Lafflin*, 5 Dill. 65, Fed. Cas. No. 7393, aff'd 103 U. S. 800, 26 L. Ed. 532; *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90, 19 Am. Dec. 306; *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 38 Am. Rep. 330; *Victor G. Bloede Co. v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L. R. A. 107, 57 Am. St. Rep. 373; *Miller v. Farmers' Milling & Elevator Co.*, 78 Neb. 441, 110 N. W. 995, 26 Am. St. Rep. 606. See 14 C. J. 667, 669, 7 R. C. L. 263.

⁴ *Victor G. Bloede Co. v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L. R. A. 107, 57 Am. St. Rep. 373; *Brinkerhoff-Farris Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447, 24 S. W. 129; *Ireland v. Globe Milling & Reducing Co.*, 19 R. I. 180, 32 Atl. 921, 29 L. R. A. 429, 61 Am. St. Rep. 756; s. c., 21 R. I. 9, 41 Atl. 258, 79 Am. St. Rep. 769.

outsiders is valid,⁵ and the weight of modern authority seems to uphold a by-law which compels a stockholder to offer his stock to the corporation or to the other stockholders before selling it to outsiders. The purpose of such by-laws is legitimate, namely to enable the organizers of the corporation to retain control of the enterprise in which they have invested their capital and to exclude business rivals from access to business secrets.⁶ If the corporation has no power to purchase shares of its own stock, a by-law and contract between it and stockholders purporting to give the company the right to purchase the stock for itself are void, but they might be upheld if construed as giving it the right to find a purchaser for the stock acceptable to the directors before sale to another.⁷

Agreements in restraint of the right to transfer shares.—An agreement between stockholders of a corporation not to sell or transfer their shares without the consent of all the parties thereto is in restraint of trade, and contrary to public policy, and is therefore void.⁸ It was so held, for example, of an agreement between stockholders of a railroad company which provided that they would

⁵ *New England Trust Co. v. Abbott*, 162 Mass. 148, 38 N. E. 432, 27 L. R. A. 271. In this case it was held that, where a person purchased certificates of stock which provided that they were transferable only to the company, and at an appraisal to be made by the directors, as provided in the by-laws printed on the back of the certificates, and signed a receipt therefor "subject to the conditions and restrictions therein referred to, and to the by-laws of the company to which I agree to conform," he was bound by the provisions of the certificates, although mere by-laws containing such provisions would have been void. See also, *Weiland v. Hogan*, 177 Mich. 626, 143 N. W. 599.

⁶ By-law of a corporation restricting the right of transfer of the shares without giving stockholders an opportunity to buy is valid. (*Nicholson v. Franklin Brewing Co.*, 82 Ohio St. 94, 91 N. E. 991, 137 Am. St. Rep. 764, 19 Ann. Cas. 699; 14 C. J., p. 669, sec. 1040; *Model Clothing House v. Dickinson*, 146 Minn. 367, 178 N. W. 957; *Sterling Loan & Inv. Co. v. Lital*, 75 Colo. 34, 223 Pac. 753). By-law that right to transfer stock

shall be subject to the company's option of purchase is valid and not an undue restraint on alienation. *Baumohl v. Goldstein*, 95 N. J. Eq. 597, 124 Atl. 118.

Barrett v. King, 181 Mass. 476, 63 N. E. 934. By-law of corporation giving corporation option to purchase held valid. Chief Justice Holmes remarks: "Stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership. Notwithstanding decisions under statutes, like *In re Klaus*, 67 Wis. 401, 29 N. W. 582, there seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm." Quoted in *Longyear v. Hardman*, 219 Mass. 405, 106 N. E. 1012, Ann. Cas. 1916 D 1200. See 5 Minnesota Law Rev. 312; 29 Yale Law Journal 352.

⁷ *State ex rel. Howland v. Olympia Veneer Co.*, 138 Wash. 144, 244 Pac. 261.

⁸ *Fisher v. Bush*, 35 Hun (N. Y.) 641; *Williams v. Montgomery*, 68 Hun (N. Y.) 416, 22 N. Y. Supp. 1033, modified 148 N. Y. 519, 43 N. E. 57.

not "assign, set over, pledge or give power of attorney to vote, or agree to sell, assign, transfer, set over, pledge, or give power of attorney to vote, in any way, shape or manner the stock which we respectively and individually own, hold or possess in said company without the concurrent consent of all signers to this instrument"; and which recited that the agreement was "made for mutual protection and to prevent the sale of the company's franchise by a majority of the members of the present board of directors, who are, and who represent, a minority of the shares of the capital of this company."⁹ This was void as an agreement not to sell for any purpose. This principle, however, does not prevent reasonable agreements between stockholders and the corporation, based upon a valid consideration, restricting the right to transfer shares. Thus, an agreement that shares shall not be transferred until all debts due from the holder to the corporation are paid is valid, and binding upon the stockholders and purchasers with notice.¹⁰

Transfers after dissolution of the corporation.—After a corporation has been dissolved by expiration of its charter, by the judgment or decree of a court, or otherwise, the stockholders have not the same power to transfer the legal title to their shares as before the dissolution, for their position is very different. After the dissolution of the corporation, their only right is an equitable right to share in the assets of the corporation after the payment of its debts, and after they have paid or been charged with any indebtedness which may have been due from them to the corporation. This equitable right may be assigned, but in such a case the assignee acquires no greater or different rights than the assignor. He does not acquire a legal title to the shares, as in the case of a transfer before dissolution.¹¹

§ 145a. Conflict of laws—What law governs transfer.

It is generally stated that the validity, requisites, and effect of a transfer of shares are governed by the laws of the state or

⁹ *Fisher v. Bush*, 35 Hun (N. Y.) 641. See *Scruggs v. Cotterill*, 67 N. Y. App. Div. 583, 588, 73 N. Y. Supp. 882.

¹⁰ *Gibbs v. Long Island Bank*, 83 Hun (N. Y.) 92; *Hey v. Dolphin*, 92 Hun 230, 36 N. Y. Supp. 627; *Farmers' Mercantile & Supply Co. v. Laun*, 146 Wis. 252, 131 N. W. 366; *Vansands v. Middlesex County Bank*, 26 Conn. 144; *Jennings v. Bank of Cal-*

ifornia, 79 Cal. 323, 21 Pac. 852, 5 L. R. A. 233, 12 Am. St. Rep. 145; *Stafford v. Produce Exchange Banking Co.*, 61 Ohio St. 160, 76 Am. St. Rep. 371. See also, post § 154.

¹¹ *James v. Woodruff*, 10 Paige (N. Y.) 541, 2 Denio (N. Y.) 574. See *People v. California Safe Deposit & Trust Co.*, 18 Cal. App. 732, 124 Pac. 558.

country in which the corporation was created, although the transfer may be made in another state or country, and both of the parties may reside there.¹² This rule is subject to qualification as is shown by a recent decision of the Supreme Court of the United States.¹³ The law of the corporation's domicile governs the transfer of stock or shares just as the title to real estate can only be acquired, passed and lost according to the *lex rei sitae*. This is because jurisdiction depends on the power of effective control. But the certificate of stock is treated as a representative of the shares, the dealing with which may be effective under the law of the state where the certificate is dealt with. By the law of the domicile one acquiring title to the certificate elsewhere will be recognized as the owner of the stock thereby represented.

The American Law Institute in its Restatement No. 2 of Conflict of Laws says: "Section 57. (1) Shares in a corporation are subject to the jurisdiction of the state in which the corporation was organized. (2) The certificate of stock is subject to the jurisdiction of the state within whose territory it is. (3) To the extent to which the state in which the corporation was organized merges the share in the certificate, the share is exclusively subject to the jurisdiction of the state which has jurisdiction over the certificate."

¹² Black v. Zacharie, 3 How. (U. S.) 483, 11 L. Ed. 690. And see Colonial Bank v. Cady, 15 App. Cas. 267; Merrimac Min. Co. v. Levy, 54 Pa. St. 227, 93 Am. Dec. 697; Masury v. Arkansas Nat. Bank, 87 Fed. 381, rev'd 93 Fed. 603; United Cigarette Mach. Co. v. Canadian Pac. Ry. Co., 12 Fed. (2d) 634; 12 C. J. 473; 14 A. C. J. 1235. Compare Lowndes v. Cooch, 87 Md. 478, 39 Atl. 1045, 40 L. R. A. 380 (bequest). See also, Husband v. Linehan, 168 Ky. 304, 181 S. W. 1089, Ann. Cas. 1917 D 954, 959 (note on law governing transfer of corporate stock).

In United Cigarette Mach. Co. v. Canadian Pac. Ry. Co., 12 Fed. (2d) 634, it is said: "Rights regarding transfer of stock of a corporation or liens attaching thereto must be determined by the law of the place of incorporation. Hammond v. Hastings, 134 U. S. 401, 33 L. Ed. 960, 10 Sup. Ct. 727; Modern Woodmen of America v. Mixer, 267 U. S. 544, 69 L. Ed. 783, 45 Sup. Ct. 389, 41 A.

L. R. 1384; Second Russian Ins. Co. v. Miller, 268 U. S. 552, 69 L. Ed. 1088, 45 Sup. Ct. 593. The question of who must be recognized as the shareholders is to be determined by the law of Canada; likewise, whether or not interest is payable. Direction der Disconto-Gesellschaft v. United States Steel Corp., 267 U. S. 22, 69 L. Ed. 495, 45 Sup. Ct. 207, we think consistent with these views."

¹³ Direction der Disconto-Gesellschaft v. United States Steel Corp., 267 U. S. 22, 69 L. Ed. 495, 45 Sup. Ct. 207, aff'g 300 Fed. 741: "The question who is owner of the paper (the certificates) depends upon the law of the place where the paper is." See United Cigarette Mach. Co. v. Canadian Pac. Ry. Co., 12 Fed. (2d) 634; Williams v. Colonial Bank, [1888] 38 Ch. Div. 388, [1890] 15 A. C. 267. Situs of stock where transfer office is maintained in foreign jurisdiction, see 25 Columbia Law Rev. 232.

Suppose that a stock certificate for 100 shares in the X corporation created by state A is indorsed in blank and placed by O, the owner, in a safe deposit box in state B. It is then lost or stolen from the box. The certificate is sold to P, an innocent purchaser for value in state B, by the thief and finder. In state B, certificates of stock both in foreign and domestic corporations have been made negotiable by statute. In state A, the state of incorporation, they have not been made negotiable, and there is no ground of estoppel against the true owner, O. The courts of state A should recognize and give effect to the title of P valid under the law of the situs of the purchase of the certificate, in a suit by P against O and X in state A, to be registered as owner of the shares.¹⁴

The conflict in the laws of the different states governing stock transfers may be harmonized by recognizing as valid transfers made either according to the law of the domicile of the corporation or according to the law of the state or country where the certificate is dealt with. This is subject to the qualification that a title acquired under the law of the domicile, as by execution sale, may in some cases be given priority over a transfer of the certificate in another state. Corporate shares have such existence at the corporate domicile that they may be levied upon, attached or seized by service on the corporation, although the certificate, its holder and owner are outside the jurisdiction. But the law of the domicile does not refuse to recognize transactions concerning the shares when represented by the certificates outside its boundaries. Seizure of the certificate under statutes of a foreign jurisdiction may transfer title to the securities under the law of the domicile. Since the certificate is the controlling representative of the owner's rights, the title to the shares may be affected by transactions under the law of the place where the certificate is located, and transfers effected under that law will be recognized by the courts of the state of incorporation. A certificate is regarded much as a chattel, and the law of the situs governs the transfer. In some states the interest of the owner of shares of stock in a foreign corporation may be attached or levied on when the certificates can be seized. The certificates are treated as if they were the property itself.¹⁵

¹⁴ What law governs transfer of stock, 9 Min. Law Rev. 661, 674; 39 Harvard Law Rev. 486; *Direction der Disconto-Gesellschaft v. United States Steel Corp.*, 267 U. S. 22, 69 L. Ed. 495, 45 Sup. Ct. 207, aff'g 300 Fed. 741, 746. The result might be other-

wise if the certificate indorsed in blank had been lost or stolen in state A and taken into state B without O's consent.

¹⁵ *Simpson v. Jersey City Contracting Co.*, 165 N. Y. 193, 58 N. E. 896, 55 L. R. A. 796. A levy on a certi-

In *Direction der Disconto-Gesellschaft v. United States Steel Corporation*,¹⁶ plaintiffs owned shares of stock in the United States Steel Corporation of New Jersey. These shares were registered in the names of British subjects resident in England. The certificates were indorsed in blank and were held in England for German corporations. The Public Trustee of England, under the Trading with the Enemy Act, seized the certificates as the property of alien enemies. The defendant corporation then refused to register the shares in the name of the plaintiffs, claiming that title to the shares was in the Public Trustee, as provided by English law. The plaintiffs sued the Public Trustee and the corporation to establish title to their shares. It was held that the title to the shares was in the Public Trustee. As the acts done in England transferred title to the certificates to this official, he was entitled to registration on the books of the corporation and to the issuance of new certificates to himself. The question thus presented was whether seizure of the certificates in Great Britain constituted a seizure of the shares in the New Jersey corporation represented thereby. The basis of jurisdiction is actual or potential power. Power can be exerted against the corporation effectively only in the state of incorporation. It is only at the corporate domicile that the corporation may be compelled to recognize a transfer. But the law of the domicile will give legal effect to acts and events happening elsewhere, such

ficate of stock in a foreign corporation may be effective if the words of the statute are broad enough. The court must presume that the foreign corporation will recognize and give effect to the purchaser's title, even if it cannot compel a transfer on the books by its own order. See *General Motors Corp. v. Ver Linden*, 199 N. Y. App. Div. 375, 192 N. Y. Supp. 28; *Mitchell v. Leland Co.*, 246 Fed. 103; *Moys v. Union Trust Co.*, 276 Pa. 58, 119 Atl. 738. See also, *Griswold v. Kelly-Springfield Tire Co.*, 94 N. J. Eq. 308, 120 Atl. 324. Stock has for some purposes a situs in the state where the certificate is dealt with. *Cook, Corporations* (8th Ed.), sec. 485. Attachment of stock in foreign corporation, see note in 3 *North Carolina Law Rev.* 103, criticising *Parks-Cramer v. Southern Exp. Co.*, 185 N. C. 428, 117 S. E. 505, allowing attachment of shares of stock in a

foreign corporation doing business in North Carolina and having property there, though the certificates were not within the state.

¹⁶ 267 U. S. 22, 69 L. Ed. 495, 45 Sup. Ct. 207, aff'g 309 Fed. 741. As Learned Hand, J., says: "I have to decide what person the company must recognize as shareholder. In deciding that question I can only follow the law of the place where I sit. It is indeed commonly said that, when a court must consider the legal effect of events happening elsewhere, it enforces foreign law. . . . Of necessity no court can enforce the law of another place. It is, however, the general law of all civilized peoples that, in adjusting the rights of suitors, courts will impute to them rights and duties similar to those which arose in the place where the relevant transactions occurred." 300 Fed. 741, 744.

as a seizure of the certificate under foreign law or a sale of the certificate under writ of execution by virtue of the statute of another state.

§ 146. Mode of transferring shares.—Unless some particular mode is prescribed by the charter of the corporation or the general law, shares of stock may be transferred by delivery of the certificate with a written assignment thereof on the same, or on a separate paper; or, according to the better opinion, by mere delivery of the certificate, without any written assignment.

When shares are transferable on the books of the corporation, they may be transferred by delivery of the certificate with an assignment and power of attorney to transfer the same on the books executed in blank, and any subsequent holder may fill in the blanks, and cause a transfer to be registered.

It is not necessary to a valid and complete transfer that a new certificate of stock shall be issued to the transferee, or that the old certificate shall be surrendered to the corporation.

At common law, the delivery of a stock certificate with a written transfer of the same to the purchaser is sufficient to transfer the title to the shares represented thereby.^{16a}

While a certificate of stock is not necessary to render one a stockholder in a corporation, it is desirable to have one as evidence and for the purpose of transfer, and every stockholder has a right to a proper certificate as soon as he has paid for his shares, unless there is some provision or agreement to the contrary.

A certificate may be in the following form:

Number D. 3		Shares \$100 each
	Common Stock.	
10 shares		10 shares
	The Canadian Pacific Railway Co.	
	Dominion of Canada.	

This certifies that A. B. is the owner of ten paid-up shares of the capital stock of the Canadian Pacific Railway Co. of one hundred dollars each, transferable only on the books of the company in person or by attorney and upon the surrender of this certificate.

This certificate shall not become valid until countersigned by the transfer agent and also by the registrar of transfers.

^{16a} Boston Music Hall Ass'n v. Cory, 129 Mass. 435; Scott v. Pequonnock Nat. Bank, 15 Fed. 494; 21 Blatchf. 203; McAllister v. Kuhn, 96 U. S. 87, 24 L. Ed. 615; Scripture v.

Francetown Soap-stone Co., 50 N. H. 571; McNeil v. Tenth Nat. Bank, 46 N. Y. 325, 7 Am. Rep. 341; Broadway Bank v. McElrath, 13 N. J. Eq. 24.

In testimony whereof the company has caused this certificate to be signed by its president and secretary this _____ day of _____
(Seal of Company)

President

Transfer Agent.

Secretary

Registrar of Transfers

Where, as is generally the case, shares are required to be transferred on the books of the corporation, the assignment of the certificate is generally accompanied by a written power of attorney to make the transfer, although it seems that a power of attorney is not necessary.^{16b}

The following form of transfer may be indorsed upon the certificate:

For value received _____ have bargained, sold, assigned, and transferred, and by these presents do bargain, sell, assign, and transfer unto _____ shares of the capital stock of the Canadian Pacific Railway Company mentioned in the within certificate, and do hereby constitute and appoint _____ true and lawful attorney irrevocably for _____ and in _____ same and stead to _____ use, to sell, assign, transfer, and set over all or any part of the said stock, and for that purpose to make and execute all necessary acts of assignment and transfer, and one or more persons to substitute with like full power.

Dated _____

Signed and acknowledged in presence of _____

Substitution.

We hereby irrevocably constitute and appoint _____ our substitute to transfer the within named stock under the foregoing power of attorney, with like power of substitution.

Dated _____

Ordinarily, the transfer may be made by indorsing on the certificate, or by writing on a separate paper, an assignment and power of attorney to a particular person, or the assignment and power of attorney may be executed in blank. The latter is the usual mode. In such a case, the certificate may be transferred from

^{16b} Johnson v. Lafin, 5 Dill. 65, Fed. Cas. No. 7393, aff'd 103 U. S. 800, 26 L. Ed. 532.

The Uniform Stock Transfer Act provides: Sec. 20. A certificate is indorsed when an assignment or a power of attorney to sell, assign, or transfer the certificate or the share represented thereby is written on the

certificate and signed by the person appearing by the certificate to be the owner of the shares represented thereby, or when the signature of such person is written without more upon the back of the certificate. In any such cases a certificate is indorsed though it has not been delivered. Uniform State Laws, Annotated, Terry, p. 852.

hand to hand by delivery, like a note indorsed in blank, and any holder thereof has authority to fill in his own name as transferee, and his own name or another's as attorney, and cause the transfer to be registered on the books of the corporation.¹⁷

By the weight of authority, a valid gift of stock, either *inter vivos* or *causa mortis*, may be made by delivery of the certificate of stock, accompanied by words of absolute and present gift, without any written assignment or indorsement or express power of attorney thereon or accompanying it.¹⁸

The contrary has been held in England, Maryland, New Jersey and Louisiana, in the case of a gift attempted by mere delivery of the certificate without writing.¹⁹ It is a question how far a gift of stock may be made by execution and delivery of a separate assignment, amounting to a deed or otherwise, not accompanied by a delivery of the certificate. In a number of cases it is held that a title to shares of stock may pass without any delivery of the cer-

¹⁷ *Brittan v. Oakland Bank of Savings*, 124 Cal. 282, 57 Pac. 84, 71 Am. St. Rep. 58; *Kortright v. Buffalo Commercial Bank*, 20 Wend. (N. Y.) 91; *Commercial Bank of Buffalo v. Kortright*, 22 Wend. (N. Y.) 348, 34 Am. Dec. 317; *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325, 7 Am. Rep. 341; *Holbrook v. New Jersey Zinc Co.*, 57 N. Y. 616; *Johnson v. Laffin*, 5 Dill. 65, Fed. Cas. No. 7393, aff'd 103 U. S. 800, 26 L. Ed. 532; *Broadway Bank v. McElrath*, 13 N. J. Eq. 24; *Morris v. Hussong Dyeing Mach. Co.*, 81 N. J. Eq. 256, 86 Atl. 1026; *Barnhouse v. Dewey*, 83 Kan. 12, 109 Pac. 1081, 29 L. R. A. (N. S.) 166.

To constitute a transfer there must be a delivery. A mere agreement to assign shares, where the owner retains control, is not a transfer, and does not divest his title. *Bank of Atchison County v. Durfee*, 118 Mo. 431, 24 S. W. 133, 40 Am. St. Rep. 396. But in the absence of express provision to the contrary, stock may be transferred by delivery of a separate written transfer, without the delivery of any certificate. *Grymes v. Hone*, 49 N. Y. 17, 10 Am. St. Rep. 813; *Smith v. Savin*, 141 N. Y. 315, 36 N. E. 338; *Curtis v. Crossley*, 59 N. J. Eq. 358, 45 Atl. 905.

¹⁸ *Commonwealth v. Compton*, 137 Pa. St. 138, 20 Atl. 417; *Grymes v.*

Hone, 49 N. Y. 17, 10 Am. St. Rep. 813; *Leyson v. Davis*, 17 Mont. 220, 42 Pac. 775, 31 L. R. A. 429; writ of error dismissed 170 U. S. 36, 42 L. Ed. 939, 18 Sup. Ct. 500; *Ridden v. Thrall*, 125 N. Y. 572, 26 N. E. 627, 11 L. R. A. 684, 21 Am. St. Rep. 758; *Talbot v. Talbot*, 32 R. I. 72, 78 Atl. 535, Ann. Cas. 1912 C 1221; *Herbert v. Simson*, 220 Mass. 480, 108 N. E. 65, L. R. A. 1915 D 733. See Gifts of corporation shares, *Mechem*, 20 Illinois Law Rev. 9; 30 Yale Law Journal 767.

¹⁹ *Heyer v. Sullivan*, 88 N. J. Eq. 165, 102 Atl. 248, 249, noted in 29 Yale Law Journal 956; *Matthews v. Hoagland*, 48 N. J. Eq. 455, 21 Atl. 1054; *Pennington v. Gittings*, 2 Gill & J. (Md.) 208, 209; *Baltimore Retort & Fire Brick Co. v. Mali*, 65 Md. 93, 3 Atl. 286, 57 Am. Rep. 304; *Sinnot v. Hibernia Bank*, 105 La. 705, 712, 30 So. 233.

See in re *Weston*, L. R. [1902] 1 Ch. 680; in re *Lee*, L. R. [1918] 2 Ch. 320; *Mechem*, 20 Illinois Law Rev. 9, 19: "The New Jersey and Maryland cases, it is submitted are subject to criticism both as putting a mistaken interpretation on statutory requirements and as drawing an unjustifiable distinction between gifts of stock and gifts of other securities."

tificates by the execution of a written assignment not under seal.²⁰ Other courts have refused to recognize a gift of stock even though made by a sealed instrument of transfer where there was no delivery of the certificate.²¹

Shares in a corporation exist independently of any certificate, which is the mere paper representative or evidence of the incorporeal right. It is accordingly held, in the absence of statute, that the shares may be assigned by bill of sale or any mode that will suffice to pass title to a chose in action or intangible property, without delivery of the certificate.²² A particular mode of transferring shares of stock is sometimes prescribed by the charter of the corporation or general law, or by its by-laws, and compliance therewith may be necessary to render a transfer valid as against the corporation. But the fact that a transfer of shares is not made in the manner prescribed by the charter, general law, or by-laws of the corporation does not necessarily render it void as between the parties. Ordinarily a transfer which is not made in the prescribed mode, but which would be sufficient at common law, will convey at least an equitable title to the purchaser, and he will be protected therein by a court of equity.²³

Under the Uniform Stock Transfer Act, adopted now in seventeen states, delivery of the certificate is essential to transfer legal title. The act provides, in section 1: "Title to a certificate and to the shares represented thereby can be transferred only, (a) By delivery of the certificate indorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby or (b) By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign, or transfer the same or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares repre-

²⁰ *Harris v. Harris*, 222 Ill. App. 164; *In re Cohn*, 187 N. Y. App. Div. 392, 176 N. Y. Supp. 225; *In re Valentine's Estate*, 122 N. Y. Misc. 486, 204 N. Y. Supp. 284. But see 20 Illinois Law Rev. 9, 22.

²¹ *Allen-West Commission Co. v. Grumbles*, 129 Fed. 287. See *Bailey v. Orange Memorial Hospital*, — N. J. —, 102 Atl. 7; 20 Illinois Law Rev. 9, 23.

²² *Young v. New Pedrara Onyx Co.*, 48 Cal. App. 1, 192 Pac. 55, 60; *Lip-*

seomb's Adm'r v. Condon, 56 W. Va. 416, 49 S. E. 392, 67 L. R. A. 670, 107 Am. St. Rep. 938.

²³ *Young v. New Pedrara Onyx Co.*, 48 Cal. App. 1, 192 Pac. 55; *Gilbert v. Manchester Iron Mfg. Co.*, 11 Wend. (N. Y.) 627; *Home Stock Ins. Co. v. Sherwood*, 72 Mo. 461; *Valley View Consol. Gold Min. Co. v. Whitehead*, 66 Colo. 237, 180 Pac. 737. See *Hale v. West Porto Rico Sugar Co.*, 200 N. Y. App. Div. 577, 193 N. Y. Supp. 555.

sented thereby. Such assignment or power of attorney may be either in blank or to a specified person.”²⁴

Professor T. D. Kenneson gives the following description of what is done to effect what is called a transfer of shares of stock on the books of a corporation.²⁵

“Suppose A is the registered owner of one hundred shares of stock of a corporation, which we will call the Jones Company, for which he holds a certificate and that he wishes to ‘transfer’ these shares to B.

“The Jones Company will probably have three books, one known as the ‘transfer’ book, another as the stock certificate book, and a third as the stock ledger. In the ‘transfer’ book will be printed ‘transfers’ in this form: ‘For value received.....hereby assign and transfer unto.....shares in the capital stock of the Jones Company.’ The certificate book will contain printed blank certificates with margins for entering the time of issuing the certificate, the number of shares, the number of the certificate and to whom issued. The stock ledger will contain an account with each shareholder, in which he is credited with all shares ‘transferred’ by others to him and debited with all shares ‘transferred’ by him to others.

“If the certificate of the Jones Company has the form usual today in this country, after declaring A entitled to one hundred shares of the capital stock of the Jones Company, it will state that they are transferable on the books of the company at its office by A or attorney on the surrender of the certificate.

“One method of ‘transfer’ is this: A delivers to B his (A’s) certificate. A and B then go to the company’s office and see the ‘transfer’ clerk. A signs in the ‘transfer’ book an assignment and ‘transfer’ to B of all right, title and interest in one hundred shares of the capital stock of the Jones Company. B surrenders to the company the certificate held by him for cancellation. The ‘transfer’ clerk takes from the certificate book a blank form of certificate

²⁴ See Uniform State Laws, Annotated, Terry, pp. 345, 349. Section 9 provides: “The delivery of a certificate by a person appearing by the certificate to be the owner thereof without the indorsement requisite for the transfer of the certificate and the shares represented thereby, but with intent to transfer such certificate or shares shall impose an obligation, in the absence of an agreement to the

contrary, upon the person so delivering, to complete the transfer by making the necessary indorsement. The transfer shall take effect as of the time when the indorsement is actually made. This obligation may be specifically enforced.

²⁵ T. D. Kenneson, *Purchase for Value without Notice*, 23 Yale Law Journal 193, 199. See also, Fletcher, *Corporations*, sec. 3791.

and fills in B's name as entitled to one hundred shares of the capital stock of the company, has it signed by the proper officers and delivers it to B. He then debits A in his account in the stock ledger with one hundred shares 'transferred' by him to B and opens an account with B and credits him with the one hundred shares 'transferred' to him by A.

"Another method is this: A delivers the certificate to B and also a formal instrument of assignment and 'transfer' signed by A. This may be separate from the certificate, but is generally printed on its back. Despite this 'transfer' A still goes to the company's office and signs an additional assignment and 'transfer' in the company's 'transfer' book.

"A third and the most usual method is this: A delivers the certificate to B. He also signs and delivers to B a formal instrument of assignment and 'transfer' and power of attorney authorizing a person, whose name is generally left blank, to be subsequently filled in to sign a 'transfer' in the corporate 'transfer' book. This enables the 'transferee' to have himself registered as owner without A's presence. The blank power of attorney is generally filled in by the 'transfer' clerk writing in his own name, who thereby becomes A's attorney to sign the requisite 'transfer' in the company's 'transfer' book. The 'transfer' and power of attorney may of course be separate from the certificate or, as is usual, printed on the back of the certificate.

"The question naturally arises, why does A either in person or by attorney sign an assignment and 'transfer' in the 'transfer' book of the company, after having already signed such an assignment and 'transfer' and delivered it to B? If B delivers to the company the certificate and 'transfer,' the company has ample authority to cancel the shares represented by the certificate and issue a like number of new shares in their place. The reason would seem to be one of convenience only, that the company may have its 'transfers' bound together in book form, rather than detached from each other.²⁶

"The careful reader will have noted that the word 'transfer' is used in two meanings. In one sense it is applied to a formal instru-

²⁶ "The second 'transfer' in the 'transfer' book is superfluous and the company may dispense with its requirement.

"The assignee by signing the assignor's name to the formal instrument of assignment and 'transfer'

creates no new substantive right in himself. At most the formal instrument of assignment and 'transfer' is mere evidence to the company of the assignee's right to be substituted as stockholder in place of the so-called assignor or 'transferor.'

ment of 'transfer' executed by the so-called 'transferor,' in person or by attorney, to the so-called 'transferee' and contained at times in the corporate 'transfer' book and at times not. In the other sense it seems to mean the completed transaction by which one person is substituted in place of another as stockholder in a corporation, which, of course, is not a 'transfer,' but a substitution or novation."

§ 147. Registration of transfers on the books of the corporation.—Registration of a transfer on the books of the corporation is not necessary unless required by the charter or general law, or by an authorized by-law; but in most jurisdictions there is such a requirement. The courts have not agreed as to the effect of a failure to comply with such a requirement. The following propositions, however, are supported by the weight of authority:

- (1) An unregistered transfer does not pass the legal title, but it passes an equitable title, good as between the parties, which will prevail as against all persons who seek to enforce a right acquired with notice of the transfer. In some jurisdictions it has been held that an unregistered transfer passes the legal title as between the parties.
- (2) An unregistered transfer does not make the transferee a stockholder, or entitle him to any rights as such as against the corporation, unless it has notice, and until it receives notice it may safely treat the transferrer as the owner of the shares.
- (3) An unregistered transfer does not relieve the transferrer from liability to creditors of the corporation, or make the transferee liable.
- (4) An unregistered transfer will not prevail as against a bona fide purchaser or pledgee from the person appearing on the books as owner. It is otherwise, however, if he has notice of the transfer.
- (5) There is a direct conflict in the decisions as to the effect of an unregistered transfer as against subsequent attaching or execution creditors of the person appearing on the books as owner:
 - (a) In some jurisdictions, the creditor acquires a lien as against the transferee, if the attachment or execution was levied without notice of the transfer, but not if it was levied with notice.

- (b) In most jurisdictions, the creditor acquires no lien or right as against the transferee, even though the levy was made without notice of the transfer.

Entry or registration of a transfer of shares on the books of the corporation is not necessary to the validity of the transfer, or the substitution of the transferee for the transferor as a stockholder, either as between the parties themselves, or as against the corporation or its creditors, or as against a subsequent attaching creditor of the transferor, unless such a formality is expressly required by or under the charter of the corporation or some general law, or by a valid by-law of the corporation.²⁷ Generally, however, the charter of a corporation or the general law under which it is formed expressly provides that its shares shall be transferable only on the books of the corporation in such manner as the articles of association or by-laws may prescribe. There is such a provision in the act of congress relating to national banks, and in the general corporation laws of most of the states. In construing such requirements, the courts agree to some extent, but, as we shall see, on some questions the decisions are in irreconcilable conflict.

Effect of unregistered transfer as between the parties.—In most jurisdictions, the courts have held that a provision that the stock of the corporation shall be transferable only on the books of the corporation, does not render registration of a transfer on the books absolutely essential to pass the title to the stock as between the parties. In many jurisdictions it is held that registration or a proper demand of registration is essential to pass the legal title. But it is well settled, even in these jurisdictions, that an unregistered transfer gives the transferee a *perfect equitable title* as between him and the transferor, or any person standing in the shoes of the transferor.²⁸ "It seems too clear for argument," said the

²⁷ Boston Music Hall Ass'n v. Cory, 129 Mass. 435; People ex rel. Pickering v. Devin, 17 Ill. 84; Lipscomb's Adm'r v. Condon, 56 W. Va. 416, 49 S. E. 392, 67 L. R. A. 670, 107 Am. St. Rep. 938.

²⁸ Baker v. Davie, 211 Mass. 429, 97 N. E. 1094, 37 L. R. A. (N. S.) 944; Fisher v. Essex Bank, 5 Gray (Mass.) 373; Dickinson v. Central Nat. Bank, 129 Mass. 279, 37 Am. Rep. 351; Nicollet Nat. Bank v. City

Bank, 38 Minn. 85, 35 N. W. 577, 8 Am. St. Rep. 643; Buttrick v. Nashua & L. R. Co., 62 N. H. 413, 13 Am. St. Rep. 578; Scripture v. Frances-town Soapstone Co., 50 N. H. 571; Johnson v. Laffin, 5 Dill. 65, Fed. Cas. No. 7393, aff'd 103 U. S. 800, 26 L. Ed. 532; Continental Nat. Bank v. Eliot Nat. Bank, 7 Fed. 369; Scott v. Pequonnock Nat. Bank, 21 Blatchf. 203, 15 Fed. 494; Hotchkiss & Upson Co. v. Union Nat. Bank, 68 Fed.

New Hampshire court, "that the ownership of the shares passes from the seller to the buyer by force of the contract of sale, and not by operation of law; and if that be so, the buyer's title, so far as the seller is concerned, attaches the moment this contract is fully consummated between them."²⁹

In some jurisdictions the courts have construed such provisions as intended merely for the protection of the corporation, so that it may know who are its stockholders, and as such entitled to receive dividends, vote at corporate elections, etc., and for the protection of *bona fide* purchasers of shares, and have held, therefore, that an unregistered transfer of shares passes the legal title, and not merely an equitable title, as between the transferor and transferee, although, as against the corporation and *bona fide* purchasers, it passes an equitable title only.³⁰ Since an unregistered transfer is good as between the parties, and since an assignee in bankruptcy or for the benefit of creditors stands in the shoes of the bankrupt or assignor, a *bona fide* unregistered transfer of stock will prevail as against a subsequent assignment by the transferor for the benefit of creditors, or a subsequent assignee in bankruptcy or insolvency proceedings.³¹

These statutes regulating the transfer of stock are generally construed as intended solely for the benefit of the corporation and prescribe a method of transfer which shall be effectual as between the corporation and its stockholders in matters relating to internal management rather than one which must be observed between a stockholder and third parties. "It is apparent that the transfer on

76; Fort Madison Lumber Co. v. Batavian Bank, 71 Iowa 270, 32 N. W. 336, 60 Am. Rep. 789; Harpold v. Stobart, 46 Ohio St. 397, 21 N. E. 637, 15 Am. St. Rep. 618; Lippitt v. American Wood Paper Co., 15 R. I. 141, 23 Atl. 111, 2 Am. St. Rep. 886; Talbot v. Talbot, 32 R. I. 721, 78 Atl. 535, Ann. Cas. 1912 C 1221; Lipscomb's Adm'r v. Condon, 56 W. Va. 416, 49 S. E. 392, 67 L. R. A. 670, 107 Am. St. Rep. 938.

²⁹ Scripture v. Francetown Soapstone Co., 50 N. H. 571; Fidelity Trust Co. v. Newark Milk & Cream Co., — N. J. Law —, 108 Atl. 54; Birmingham Trust & Savings Co. v. Cannon, 204 Ala. 336, 85 So. 768.

³⁰ Travis v. Knox Terpezzone Co., 215 N. Y. 259, 109 N. E. 250, L. R. A. 1916 A 542, Ann. Cas. 1917 A 387; McNeil v. Tenth Nat. Bank, 46

N. Y. 325, 7 Am. Rep. 341. "The holder of such a certificate and power possesses all the external *indicia* of title to the stock, and an apparently unlimited power of disposition over it. He does not appear to have a mere equitable interest . . . but apparently the legal title." Robinson v. National Bank of New Berne, 95 N. Y. 637; Broadway Bank v. McElrath, 13 N. J. Eq. 24; McLean v. Charles Wright Medicine Co., 96 Mich. 479, 56 N. W. 68. See Northwestern Portland Cement Co. v. Atlantic Portland Cement Co., 174 Cal. 308, 163 Pac. 47; Hale v. West Porto Rico Sugar Co., 200 N. Y. App. Div. 577, 193 N. Y. Supp. 555.

³¹ Dickinson v. Central Nat. Bank, 129 Mass. 279, 37 Am. Rep. 351; Sibley v. Quinsigamond Nat. Bank, 133 Mass. 515.

the books can logically be regarded only as a formality that succeeds the actual transfer between the parties.”³² The principal object of registry of a transfer on the books and obtaining a new certificate in the name of transferee is to obtain the rights of an acknowledged stockholder as against the corporation, viz.: (1) the right to vote; (2) the right to receive dividends, notices and reports; (3) to cut off possible corporate liens for debts of the transferrer, and possible claims of his creditors. But as Cook points out hundreds of millions of dollars are loaned with no other security than certificates of stock indorsed in blank and delivered with no registry whatsoever on the corporate books.^{32a}

Effect of unregistered transfer as against the corporation.—

When there is a valid provision in the charter, general law, or by-laws of a corporation that its shares shall be transferable only on the books, a transfer must be registered, or, at least, notice thereof given to the corporation for the purpose of registration, in the absence of a waiver or estoppel, before the transferee can acquire any rights as against the corporation other than the right to have the transfer registered, or incur any liability, and before the transferrer can be relieved from liability to the corporation. This is true in all jurisdictions, whether it is held that an unregistered transfer passes the legal title, or merely an equitable title, as between the transferrer and transferee, for all the courts agree that the requirement of registration is intended for the protection of the corporation by enabling it to know who are stockholders in all matters of internal management.³³ It is well settled, therefore, when there is such a requirement, that, until transfers are registered, or the corporation has notice thereof, the persons appearing on the books of the corporation as stockholders may safely be treated as such in the payment of dividends,³⁴ and in the distribu-

³² Talbot v. Talbot, 32 R. I. 72, 78 Atl. 535, Ann. Cas. 1912 C 1221; Mechem, 20 Ill. Law Rev. 9, 17-19; Morawetz, Corporations (2nd Ed.), secs. 170-197.

^{32a} Cook, Corporations (8th Ed.), sec. 444.

³³ London & Brighton Ry. Co. v. Fairclough, 2 Man. & G. 674; Humble v. Langston, 7 Mees. & W. 517; Union Bank of Georgetown v. Laird, 2 Wheat. (U. S.) 390, 4 L. Ed. 269; Becher v. Wells Flouring Mill Co., 1 McCrary 62, 1 Fed. 276; Merchants' Nat. Bank of Cincinnati v. Wehr-

mann, 202 U. S. 295, 50 L. Ed. 1036, 26 Sup. Ct. 61; Brisbane v. Delaware, L. & W. R. Co., 94 N. Y. 204; Whitfield v. Nonpareil Consol. Copper Co., 67 Wash. 286, 123 Pac. 1078, 41 L. R. (N. S.) 187.

³⁴ Brisbane v. Delaware, L. & W. R. Co., 94 N. Y. 204; Cleveland & M. R. Co. v. Robbins, 35 Ohio St. 483; Guarantee Co. of North America v. East Rome Town Co., 96 Ga. 511, 23 S. E. 503, 51 Am. St. Rep. 150; Richter & Co. v. Light, 97 Conn. 364, 116 Atl. 600.

tion of assets upon a dissolution of the corporation.³⁵ It is otherwise, as we have seen, if the corporation has notice of the transfer, for an unregistered transfer is good as between the parties.³⁶

Registration of transfers, when required, or demand for registration, is also necessary to entitle the transferees to vote at corporate meetings, and deprive the transferrers of their right to vote;³⁷ to entitle the transferee to hold office as a director or other officer of the corporation, where *status* as a stockholder is made necessary to the qualification of officers;³⁸ and to relieve the transferrer from liability for calls upon the stock, or render the transferee liable,³⁹ unless the requirement of registration is waived, as it may be.⁴⁰

Registration of a transfer, when required, or notice of the transfer, is necessary to prevent the corporation from acquiring a lien on the shares for debts of the transferrer, when a lien is given by the charter or general law, or to prevent it from acquiring such a lien by contract with the transferrer.⁴¹ But, since an unregistered transfer is good as between the parties, if the corporation has notice of the transfer, it cannot afterwards lend money to the

³⁵ In re Bank of Commerce's Appeal, 73 Pa. St. 59; Campbell v. Perth Amboy Mut. Loan Homestead & Building Ass'n, 76 N. J. Eq. 347, 74 Atl. 144. But see Bath Sav. Inst. v. Sagadahoc Nat. Bank, 89 Me. 500, 36 Atl. 996, as to requiring production of certificate.

³⁶ Robinson v. National Bank of New Berne, 95 N. Y. 637; Boyd v. Conshohocken Worsted Mills, 149 Pa. St. 363, 24 Atl. 287; Gemmell v. Davis, 75 Md. 546, 23 Atl. 1032, 32 Am. St. Rep. 412; Guarantee Co. of North America v. East Rome Town Co., 96 Ga. 511, 23 S. E. 503, 51 Am. St. Rep. 150. And see post, § 160.

³⁷ People ex rel. Probert v. Robinson, 64 Cal. 373, 1 Pac. 156; In re Argus Printing Co., 1 N. D. 434, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; Becher v. Wells Flouring-Mill Co., 1 McCrary 62, 1 Fed. 276; Morrill v. Little Falls Mfg. Co., 53 Minn. 371, 55 N. W. 547, 21 L. R. A. 174; State ex rel. White v. Ferris, 42 Conn. 560.

³⁸ In re Argus Printing Co., 1 N. D. 434, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; People ex rel. Matthiessen v. Lihme, 269 Ill. 351, 109 N. E. 1051, Ann. Cas. 1916 E

959. Transferer may continue to act as director until transfer on the books, State ex rel. White v. Ferris, 42 Conn. 560. But see Chemical Nat. Bank of New York v. Colwell, 132 N. Y. 250, 30 N. E. 644.

³⁹ London & Brighton Ry. Co. v. Fairclough, 2 Man. & G. 674; Marlborough Mfg. Co. v. Smith, 2 Conn. 579; Dane v. Young, 61 Me. 160; Visalia & T. R. Co. v. Hyde, 110 Cal. 632, 43 Pac. 10, 52 Am. St. Rep. 136; People's Home Sav. Bank v. Stadtmuller, 150 Cal. 106, 88 Pac. 280; Basting v. Northern Trust Co. 61 Minn. 307, 63 N. W. 721.

⁴⁰ Upton v. Burnham, 3 Bliss. 431, Fed. Cas. No. 16798; Wichita Union Terminal R. Co. v. Kansas City, M. & O. R. Co., 100 Kan. 83, 163 Pac. 1067; Ohman v. Lee, 149 Minn. 451, 184 N. W. 41.

⁴¹ Union Bank of Georgetown v. Laird, 2 Wheat. (U. S.) 390, 4 L. Ed. 269; Stafford v. Produce Exchange Banking Co., 61 Ohio St. 160, 55 N. E. 162, 76 Am. St. Rep. 371; Gemmell v. Davis, 75 Md. 546, 23 Atl. 1032, 32 Am. St. Rep. 412; Jennings v. Bank of California, 79 Cal. 323, 21 Pac. 852, 5 L. R. A. 233, 12 Am. St. Rep. 145.

transferrer, or otherwise allow him to contract a debt, and then claim a lien on the ground that the debt was contracted before the transfer was registered.⁴²

Effect of unregistered transfer as against creditors of the corporation.—In most jurisdictions, provisions that shares of stock shall be transferable only on the books of the corporation are regarded as intended, not only for the protection of the corporation, but also for the protection of persons dealing with the corporation, so that they may know who are stockholders; and it is very generally held, therefore, that a transfer which is not registered or deposited for registration does not relieve the transferrer from liability to or for the benefit of creditors of the corporation for any balance that may remain unpaid on the shares, or from liability under a statute imposing a liability upon stockholders over and above the par value of their shares.⁴³

Effect of unregistered transfer as against purchasers or pledgees from the apparent owner.—According to some courts, a provision that shares of stock shall be transferable only on the books of the corporation is intended for the protection of purchasers and pledgees of shares, as well as for the protection of the corporation and persons dealing with it, and a *bona fide* purchaser or pledgee from the person who appears on the books of the corporation as the owner of shares acquires a good title as against a prior transferee who has failed to have his transfer registered. This is true, whether an unregistered transfer be regarded as passing the legal, or merely an equitable, title, as between the transferrer and transferee.⁴⁴

⁴² Hotchkiss & Upson Co. v. Union Nat. Bank, 68 Fed. 76; Birmingham Trust & Savings Co. v. Louisiana Nat. Bank, 99 Ala. 379, 13 So. 112, 20 L. R. A. 600; Prince Inv. Co. v. St. Paul & S. C. Land Co., 68 Minn. 121, 70 N. W. 1079.

⁴³ Robinson v. Southern Nat. Bank, 180 U. S. 295, 45 L. Ed. 536, 21 Sup. Ct. 383; Matteson v. Dent, 176 U. S. 521, 44 L. Ed. 571, 20 Sup. Ct. 419; Richmond v. Irons, 121 U. S. 27, 30 L. Ed. 864, 7 Sup. Ct. 788; Dane v. Young, 61 Me. 160; Shellington v. Howland, 53 N. Y. 371; Harpold v. Stobart, 46 Ohio St. 397, 21 N. E. 637, 15 Am. St. Rep. 618; Cutting v. Damerel, 23 Hun (N. Y.) 339, rev'd 88 N. Y. 410; Abilene State Bank v.

Strachan, 89 Kan. 577, 132 Pac. 200, 46 L. R. A. (N. S.) 668 (transfer to the bank itself); Bracken v. Nicol, 124 Ky. 628, 99 S. W. 920, 11 L. R. A. (N. S.) 818, 14 Ann. Cas. 896; Sherman v. S. K. D. Oil Co., 185 Cal. 534, 548, 197 Pac. 799. See on this question, post, §§ 215, 222.

⁴⁴ New York & N. H. R. Co. v. Schuyler, 34 N. Y. 30; Cady v. Potter, 55 Barb. (N. Y.) 463; Rough v. Breitung, 117 Mich. 48, 75 N. W. 147; National Bank of Pacific v. Western Pac. R. Co., 157 Cal. 573, 108 Pac. 676, 27 L. R. A. (N. S.) 987, 21 Ann. Cas. 1391; Bacon v. Traders' Oil Corp., 52 Cal. App. 172, 201 Pac. 477; Northwestern Portland Cement Co. v. Atlantic Portland Cement Co.

According to this view, a *bona fide* purchaser of shares at a sale under an execution against one who appears as owner on the books of the corporation acquires a good title as against a prior unregistered transfer of which he has no notice.⁴⁵ An unregistered transfer is ineffectual as against a subsequent purchaser of the shares from the person appearing on the books of the corporation as owner only when the purchaser is in the position of a *bona fide* purchaser. If he has notice of the prior unregistered transfer, he acquires no title as against the transferee, whether the unregistered transfer be regarded as passing the legal title, or merely an equitable title as between the parties.⁴⁶ There are some courts, however, which hold that an unregistered transferee will prevail over a purchaser at an execution or attachment sale, even though the purchaser has no notice of the transfer.⁴⁷

Effect of unregistered transfer as against attaching or execution creditors of the apparent owner.—By the great weight of authority an unregistered transfer will prevail as against a subsequent attaching or execution creditor of the transferor, whether the latter had notice of the transfer before his levy or not, unless the circumstances are such as to estop the transferee to set up his title, or the transfer is fraudulent as against the creditors of the transferor.⁴⁸ Such a transfer leaves no interest in the assignor

of New York, 174 Cal. 308, 163 Pac. 47. The effect of California Civ. Code, sec. 324, is analogous to that of statutes with reference to recording instruments affecting real property.

⁴⁵ Security Commercial & Savings Bank of El Centro v. Imperial Water Co., No. 1, 183 Cal. 488, 192 Pac. 22, 25, distinguishing National Bank of Pacific v. Western Pac. R. Co., 157 Cal. 573, 108 Pac. 676, 27 L. R. A. (N. S.) 987, 21 Ann. Cas. 1391, which dealt only with lien of an attachment levied upon the stock and holds unregistered transfer paramount to lien of a subsequent attachment against assignor, but not as against *bona fide* purchaser for value at execution sale. Naglee v. Pacific Wharf Co., 20 Cal. 529; Farmers' Nat. Gold Bank v. Wilson, 58 Cal. 600; Wetumpka Bridge Co. v. Kidd, 124 Ala. 242, 27 So. 431.

⁴⁶ Newberry v. Detroit & L. S. Iron Mfg. Co., 17 Mich. 141; Scripture v.

Francetown Soapstone Co., 50 N. H. 571; Des Moines Loan & Trust Co. v. Des Moines Nat. Bank, 97 Iowa 668, 66 N. W. 914; May v. Cleland, 117 Mich. 45, 75 N. W. 129, 44 L. R. A. 163.

⁴⁷ Everitt v. Farmers & Merchants Bank, 82 Neb. 191, 117 N. W. 401, 20 L. R. A. (N. S.) 996.

⁴⁸ McNeil v. Tenth Nat. Bank, New York City, 46 N. Y. 325, 7 Am. Rep. 341; De Comeau v. Guild Farm Oil Co., 3 Daly (N. Y.) 218; National Bank of Pacific v. Western Pac. R. Co., 157 Cal. 573, 108 Pac. 676, 27 L. R. A. (N. S.) 987, 21 Ann. Cas. 1391; Everitt v. Farmers & Merchants Bank, 82 Neb. 191, 117 N. W. 401, 20 L. R. A. (N. S.) 996; Lipscomb's Adm'r v. Condon, 56 W. Va. 416, 49 S. E. 392, 67 L. R. A. 670, 107 Am. St. Rep. 938; Snider v. Bourquin, 68 Colo. 207, 188 Pac. 787; Mapleton Bank v. Standrod, 8 Idaho 740, 71 Pac. 119, 67 L. R. A. 656, note.

which can be reached by his creditors. The transfer will, of course, be subject to prior attachments or executions properly levied by notice to the corporation, in the absence of statutes making seizure of the certificate itself essential to a levy.

The courts have not agreed as to the effect of an unregistered transfer as against subsequent attaching or execution creditors of the transferrer. A few of the courts hold that, until a transfer is registered, or deposited with the corporation for registration, the shares are subject to execution or attachment by the creditors of the transferrer, at least if they have no notice of the transfer.⁴⁹

Most of the courts hold that an unregistered transfer will prevail as against subsequent attaching or execution creditors of the transferrer, even when there is an express provision that shares shall be transferable only on the books of the corporation, and even though the creditor may have no notice of the transfer, unless registration is expressly required as against creditors of the transferrer, or unless the transfer is fraudulent as against them.⁵⁰ The general rule as to the effect of an attachment or execution is that the creditor obtains a lien only upon the title or interest of his debtor at the time.

"Shares in the stock of a corporation," said the Connecticut court, "are the subjects of sale, mortgage or pledge, and are liable to attachment and execution like other personal property. And when the question is between a vendee and an attaching creditor of the vendor, as to which of them has the better title, and it appears, as it does here, that the instrument of transfer or assignment was executed prior in point of time to the service of the attachment, then, if the vendee's purchase was made in good faith and for a valuable consideration . . . it would seem that in equity his title ought to prevail, provided he has done all that the law re-

⁴⁹ *Marbury Lumber Co. v. Hunter*, 169 Ala. 503, 53 So. 1028; *De Nunzio v. DeNunzio*, 90 Conn. 342, 97 Atl. 323; *Perkins v. Lyons*, 111 Iowa 192, 82 N. W. 486; *Fort Madison Lumber Co. v. Batavian Bank*, 71 Iowa 270, 32 N. W. 336, 60 Am. Rep. 789; *French v. White*, 78 Vt. 89, 62 Atl. 35, 2 L. R. A. (N. S.) 804, 6 Ann. Cas. 479.

⁵⁰ *Masury v. Arkansas Nat. Bank*, 93 Fed. 603; *Scott v. Pequonnock Nat. Bank*, 21 Blatchf. 203, 15 Fed. 494; *Continental Nat. Bank v. Eliot Nat. Bank*, 7 Fed. 369; *Broadway*

Bank v. McElrath, 13 N. J. Eq. 24; *Kern v. Day*, 45 La. Ann. 71; *Colt v. Ives*, 31 Conn. 25, 81 Am. Dec. 161; *Port Townsend Nat. Bank v. Port Townsend Gas & Fuel Co.*, 6 Wash. 597, 34 Pac. 155; *May v. Cleland*, 117 Mich. 45, 75 N. W. 129, 44 L. R. A. 163; *Clark v. German Security Bank*, 61 Miss. 611; *Reilly v. Absecon Land Co.*, 75 N. J. Eq. 71, 71 Atl. 248; *Boston Music Hall Ass'n v. Cory*, 129 Mass. 435; 16 Harvard Law Rev. 312; 9 Columbia Law Rev. 433; 9 Michigan Law Rev. 258.

quires of him, and all that it was possible for him to do, in taking such possession as the nature of the property is susceptible of.”⁵¹

Is failure to register transfer a badge of fraud?—Upon a sale of tangible chattels, there must, under the statutes relating to fraudulent conveyances, be a delivery and change of possession accompanying and following the sale, or it will be evidence of a fraudulent secret trust for the benefit of the vendor, which will render the sale invalid as to creditors. Possession being the usual indication of ownership of tangible property, the law looks upon the purchaser's neglect to take and hold possession of the property purchased as evidence that the sale was fictitious, and therefore, as to the vendor's creditors, treats the property as still his, notwithstanding the sale. This principle, according to some cases, applies to sales of stock in corporations. There must be such a change of possession as the property is susceptible of. If a statute requires a transfer on the books of the corporation, failure of the purchaser to take steps to procure such a transfer is a failure to take such an open possession of the stock as the nature of the property requires, and such failure, if unexplained, is evidence of a secret trust which renders the sale fraudulent and void as against an attaching or execution creditor of the vendor.⁵²

It has been generally held, however, that public policy does not require the presumption of fraud to arise from the mere continuance of the title to stock in the name of the transferrer on the books of the company when the beneficial title is elsewhere. The record of ownership on the corporate books cannot safely be made the basis of business transactions regarding the stock. Thus one placing corporate stock in the name of another to qualify him as director, retaining possession of the certificate himself, has priority over an attaching creditor of the person who is registered on the books as holder of the stock.⁵³ A transfer by indorsement and delivery of the certificate is sufficient change of possession as against creditors of the transferrer, although not registered on the books. The transferee is under no legal duty to have the

⁵¹ *Colt v. Ives*, 31 Conn. 25, 81 Am. Dec. 161.

⁵² *Colt v. Ives*, 31 Conn. 25, 81 Am. Dec. 161; *Pinkerton v. Manchester & L. R. R.*, 42 N. H. 424; *McFall v. Buckeye Grangers' Warehouse Ass'n*, 122 Cal. 468, 55 Pac. 253, 68 Am. St. Rep. 47.

⁵³ *Gray v. Graham*, 87 Conn. 601, 89 Atl. 262, 49 L. R. A. (N. S.) 1159. And see *United States v. Vaughan*, 3 Bin. (Pa.) 394, 5 Am. Dec. 375; *Scripture v. Francetown Soapstone Co.*, 50 N. H. 571.

transfer recorded in order to perfect his title as against strangers, and mere continuance of title on the books in the transferrer is no badge of fraud.⁵⁴

§ 148. Liability of shares of stock to execution or attachment, etc.—Equity jurisdiction.

At common law, a chose in action, being intangible and incapable of manual seizure and delivery, cannot be taken on execution; and shares of stock in a corporation are so much in the nature of choses in action as to be subject to the same rule. They are not subject to execution for the debts of the holder, unless they are made so by statute.⁵⁵ Nor can they be seized under the statutes relating to attachment, unless the statute so provides in express terms or by necessary implication.⁵⁶ It is within the power of the legislature, however, to make shares of stock subject to execution and attachment, and in most jurisdictions they have been made so by statute.⁵⁷

Although, for the purposes of taxation, as we have seen in another chapter, and for some other purposes, shares of stock follow the domicile of the owner, like other personal property, unless otherwise provided by statute, their *situs* for the purpose of execution or attachment is held by a majority of courts to be in the state where the corporation resides,—that is, the state by or under the laws of which the corporation was created; and it has been held, therefore, that they cannot be levied upon in another state, and that it

⁵⁴ *State Banking & Trust Co. v. Taylor*, 25 S. D. 577, 127 N. W. 590, 29 L. R. A. (N. S.) 523; *Harvey v. Stowe*, 219 Fed. 17 (California law); *Boston Music Hall Ass'n v. Cory*, 129 Mass. 435.

⁵⁵ *Howe v. Starkweather*, 17 Mass. 240; *Slaymaker v. Bank of Gettysburg*, 10 Pa. St. 373; *Haley v. Reid*, 16 Ga. 437; *Denton v. Livingston*, 9 Johns. (N. Y.) 96, 6 Am. Dec. 264; *Barnes v. Hall*, 55 Vt. 420; 6 C. J. 212.

⁵⁶ *Haley v. Reid*, 16 Ga. 437; *Plimpton v. Bigelow*, 93 N. Y. 592; *Kennedy v. Mary Lee Coal & Ry. Co.*, 93 Ala. 494, 9 So. 608; *Armour Bros. Banking Co. v. St. Louis Nat. Bank*, 113 Mo. 12, 20 S. W. 690, 35 Am. St. Rep. 691.

Statutes sometimes provide for levy of attachment or execution by leaving with the president or secretary or

managing agent a copy of the writ and notice stating that the stock or interest of the defendant is attached. *California Code Civ. Proc.*, secs. 541, 542; *Ramage v. Gould*, 176 Cal. 746, 169 Pac. 670.

⁵⁷ *Yazoo & M. V. R. Co. v. City of Clarksdale*, 257 U. S. 10, 66 L. Ed. 104, 42 Sup. Ct. 27; *Fletcher, Corporations*, sec. 482; *Cook, Corporations* (8th Ed.), sec. 3140.

It is generally held not necessary, in the absence of statute, that the certificates should be in the hands of the sheriff to be delivered to the purchaser in order to make valid an execution sale of shares. *West Coast Safety Faucet Co. v. Wulff*, 133 Cal. 315, 65 Pac. 622, 85 Am. St. Rep. 171. The sheriff gives the purchaser a certificate of the sale, which conveys all the right which the debtor had. *California Code Civ. Proc.* sec. 699.

makes no difference that the debtor resides there, or that the certificates of the stock are found there.⁵⁸ In these states shares of stock cannot be taken on execution or attachment by levying upon or seizing the certificate only, and a court can acquire no jurisdiction over stock by virtue of an attachment merely because the certificate of stock is within its jurisdiction.⁵⁹

There is, however, a decision in the United States circuit court of appeals in which it was held that, although certificates of stock are "technically" only written evidence of interests in the corporate property, they are so far in the nature of chattels that, when certificates of stock in a corporation of one state are held in pledge or as collateral in another state, the courts of the latter state may establish a lien thereon (meaning, as the decision shows, a lien on the stock represented by the certificate) in a suit commenced by substituted service under a statute authorizing such service in suits to establish liens on personal property within the state.⁶⁰ Other courts also have held that a certificate of stock in a foreign corporation is subject to levy on attachment or execution in the state where it is found if the statutes so provide.^{60a}

⁵⁸ Winslow v. Fletcher, 53 Conn. 390, 4 Atl. 250; 55 Am. Rep. 122; Ireland v. Globe Milling & Reduction Co., 19 R. I. 180, 32 Atl. 921, 29 L. R. A. 429, 61 Am. St. Rep. 756; Plimpton v. Bigelow, 93 N. Y. 592; Armour Bros. Banking Co. v. St. Louis Nat. Bank, 113 Mo. 12, 20 S. W. 690, 35 Am. St. Rep. 691; United States Express Co. v. Hurlock, 120 Md. 107, 87 Atl. 834, Ann. Cas. 1915 A 566.

There are some decisions in conflict with those above cited, and holding shares in a foreign corporation subject to attachment or garnishment. See Puget Sound Nat. Bank of Everett v. Mather, 60 Minn. 362, 62 N. W. 396; Young v. South Tredegar Iron Co., 85 Tenn. 189, 2 S. W. 202, 4 Am. St. Rep. 752. See also Cook, Corporations (8th Ed.), sec. 485; 73 Univ. Pa. Law Rev. 403, (levy and attachment upon stock certificates).

⁵⁹ Armour Bros. Banking Co. v. St. Louis Nat. Bank, 113 Mo. 12, 20 S. W. 690, 35 Am. St. Rep. 691; Christmas v. Biddle, 13 Pa. St. 223; Moys v. Union Trust Co., 276 Pa. St. 58, 119 Atl. 738; Winslow v. Fletcher, 53 Conn. 390, 4 Atl. 250, 55 Am. Rep.

122; Plimpton v. Bigelow, 93 N. Y. 592.

In a Wisconsin case it was held that, since certificates of stock are not the stock itself, the stock is not in the possession or control of one who has possession of the certificates, and therefore a creditor of an owner of shares of stock cannot reach the shares by garnishment of the person in possession of the certificates, under the statute of that state enabling a creditor to reach, by garnishment of the person in possession or control thereof, property, money, credits, or effects of the debtor, etc. O. L. Packard Machinery Co. v. Laev, 100 Wis. 644, 76 N. W. 576.

⁶⁰ Merritt v. American Steel-Barge Co., 79 Fed. 228. See, however, Jelenik v. Huron Copper Min. Co., 177 U. S. 1, 44 L. Ed. 647, 20 Sup. Ct. 559.

^{60a} Puget Sound Nat. Bank v. Mather, 60 Minn. 362, 62 N. W. 396; Simpson v. Jersey City Contracting Co., 165 N. Y. 193, 58 N. E. 896, 55 L. R. A. 796 n; General Motors Corp. v. Ver Linden, 199 N. Y. App. Div. 375, 192 N. Y. Supp. 28; Mitchell v. Leland Co., 246 Fed. 103; Cp. Miller v. Kaliwerke, 283 Fed. 746 (semble);

The tendency of the law and of legislation is to follow the business concept of stock certificates as representing the shares and controlling the title. The Uniform Stock Transfer Act carries out this concept in the endeavor to make stock certificates freely negotiable and to provide safety in dealing with them on the footing that they may be relied on as evidence of title. Such is the provision that no levy or attachment of stock for which a certificate is outstanding shall be valid until the certificate is actually seized or its transfer has been enjoined.⁶¹

One of the greatest dangers in the purchase of certificates of stock is the possibility of liens by attachment or execution levied on the stock before the transferee has secured registration of the transfer on the books. Such liens may affect the title of a *bona fide* purchaser of stock in the open market. This possibility can only be avoided by making inquiry at the office of the corporation before making the purchase. In states in which the Uniform Stock Transfer Act has been adopted, a purchaser who obtains the certificate will be protected against the possibility of attachments and executions. Under the law in many states a purchaser of stock cannot be sure that his title is good against possible attachments levied against the owner of record without an examination of the records of the corporation. Statutes have been enacted aside from the Uniform Stock Transfer Act, to protect the *bona fide* purchaser even from a prior attachment.⁶²

There is serious difficulty in levying on shares of stock where the certificates themselves cannot be reached and seized. In an Oklahoma case,⁶³ shares in a domestic corporation were owned by a nonresident who held the certificates outside the jurisdiction. At

Bank Für Handel Und Industrie v. United States Steel Corp., 267 U. S. 22, 69 L. Ed. 495, 45 Sup. Ct. 207; 63 Uni. Pa. Law Rev. 403; ante, § 145a.

⁶¹ Uniform Stock Transfer Act. "Section 13. No attachment or levy upon shares of stock for which a certificate is outstanding shall be valid until such certificate be actually seized by the officer making the attachment or levy, or be surrendered to the corporation which issued it, or its transfer by the holder be enjoined. Except where a certificate is lost or destroyed, such corporation shall not be compelled to issue a new certificate for the stock until the old certi-

ificate is surrendered to it." Uniform State Laws, Annotated, Terry, p. 350.

⁶² Clews v. Friedman, 182 Mass. 555, 66 N. E. 201. Under a Massachusetts statute a *bona fide* purchaser of a certificate of stock duly indorsed and delivered prevails over a previously attaching creditor.

⁶³ Harris v. Mid-Continent Life Ins. Co., 75 Okla. 105, 182 Pac. 85, noted in 33 Harvard Law Rev. 109. While the plaintiff became the equitable owner of the shares, he could not call upon the corporation to incur the risk of liability to a *bona fide* purchaser of the outstanding certificate by issuing him a new certificate for the same shares.

a judicial sale under statutory provisions, the plaintiff purchased the shares and demanded a transfer on the books. The corporation refused. It was held that a corporation may refuse to transfer stock on its books or issue new certificates when there are outstanding certificates which may be transferred to a *bona fide* purchaser.

In *Parkhurst v. Almy*,⁶⁴ a judgment creditor sought by a bill in equity to reach and apply shares of corporate stock held by the judgment debtor. He was unable to levy on the certificates belonging to the judgment debtor. The court refused to compel the corporation to issue new shares equal to those standing in the name of the debtor, as this might result in an overissue of stock in case of the sale of the old certificates to a *bona fide* purchaser. Confusion would be caused by two certificates being outstanding at the same time representing the same shares.

§ 149. Negotiability of certificates of stock, and title of bona fide purchasers or pledgees.—Shares of stock are not negotiable instruments, and therefore, in the absence of elements of estoppel, a transferee acquires no better title than the transferor had. But, by estoppel, a bona fide purchaser of a certificate of stock takes the same free from any secret liens or equities in favor of the corporation or third persons. And the real owner of shares may be estopped, in the case of an unauthorized transfer, to assert his title against the transferee.

Although a certificate of stock is intended as a representation that the person named therein is the owner of the number of shares therein designated, and has a right to transfer the same, and is intended to pass from hand to hand by assignment and delivery, it is well settled that such a certificate is not a negotiable instrument, in the same sense as a negotiable bill or note. And it has repeatedly been held, therefore, that a *bona fide* purchaser of a certificate of stock, in the absence of any estoppel, acquires no better title to the shares than his transferor had, and that, subject to qualifications hereafter shown, he takes the same subject to equities existing against the transferor in favor of the corporation, or of third persons.⁶⁵

⁶⁴ 222 Mass. 27, 109 N. E. 733.

⁶⁵ Colonial Bank v. Cady, 15 App. Cas. 267; Western U. Tel. Co. v. Davenport, 97 U. S. 369, 24 L. Ed. 1047; Bangor Elec. Light & Power Co. v. Robinson, 52 Fed. 520; East Birm-

ingham Land Co. v. Dennis, 85 Ala. 565, 5 So. 317, 2 L. R. A. 836, 7 Am. St. Rep. 73; Millard v. Green, 94 Conn. 597, 110 Atl. 177, 9 A. L. R. 1610; Barstow v. Savage Min. Co., 64 Cal. 388, 1 Pac. 349, 49 Am. Rep.

A *bona fide* purchaser of a certificate incurs various risks some of which are enumerated by Cook under the following heads: ^{65a} (1) The possibility of liability for the unpaid balance on the subscription price or par value of the stock; (2) liability as partner in case of defective incorporation or doing business in another state without a license; (3) danger of a corporate lien on the stock; (4) possibility of overissue of stock; (5) danger that previous holder was an infant or lunatic; (6) possibility of attachment or execution liens; (7) danger of forgery; (8) loss or theft of certificates indorsed in blank by previous holder, and others. Thus, a *bona fide* purchaser of a lost or stolen certificate of stock, indorsed in blank by the owner, acquires no title as against the owner, unless the latter has been guilty of such negligence as estops him from asserting his title.⁶⁶ The same is true where an assignment of a certificate of stock and power of attorney to transfer the same on the books of the corporation are forged, or where an assignment of a part of the shares represented by a certificate is fraudulently altered, so as to cover all the shares.⁶⁷ And a sale of shares by transfer of the certificate of stock is of no effect as against an attachment levied upon the shares before the transfer, even though the transferee be a *bona fide* purchaser.⁶⁸ Certificates of stock cannot be given the character of negotiable instruments by any usage or custom among stock brokers or others, for it is an

705; Craig v. Hesperia Land & Water Co., 113 Cal. 7, 45 Pac. 10, 35 L. R. A. 306, 54 Am. St. Rep. 316; Babcock v. Farwell, 245 Ill. 14, 91 N. E. 683, 137 Am. St. Rep. 284, 19 Ann. Cas. 74; Sewall v. Boston Water Power Co., 4 Allen (Mass.) 277, 81 Am. Dec. 701; Shaw v. Spencer, 100 Mass. 382, 97 Am. Dec. 107, 1 Am. Rep. 115; Axford v. Western Syndicate Inv. Co., 141 Minn. 412, 168 N. W. 97, 170 N. W. 587; Pollock v. National Bank, 7 N. Y. 274, 57 Am. Dec. 520; Knox v. Eden Musee American Co., 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; Young v. South Tredegar Iron Co., 85 Tenn. 189, 2 S. W. 202, 4 Am. St. Rep. 752. See Ballantine, Purchase for value, 6 Minnesota Law Rev. 92.

^{65a} Cook, Corporations, secs. 417-439.

⁶⁶ East Birmingham Land Co. v. Dennis, 85 Ala. 565, 5 So. 317, 2 L. R. A. 836, 7 Am. St. Rep. 73; Bartsow v. Savage Min. Co., 64 Cal. 388, 1 Pac. 349, 49 Am. Rep. 705; Swim v. Wilson, 90 Cal. 126, 27 Pac. 33, 25 Am. St. Rep. 110; Knox v. Eden Musee American Co., 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; Bangor Elec. Light & Power Co. v. Robinson, 52 Fed. 520. And see post, § 151.

⁶⁷ Pollock v. National Bank, 7 N. Y. 274, 57 Am. Dec. 520; Sewall v. Boston Water Power Co., 1 Allen (Mass.) 277, 81 Am. Dec. 701. And see post, § 151.

⁶⁸ Young v. South Tredegar Iron Co., 85 Tenn. 189, 2 S. W. 202, 4 Am. St. Rep. 752.

established rule of law that such certificates are not to be regarded as negotiable paper, and no usage or custom is good if it conflicts with an established rule of law.⁶⁹

The Uniform Stock Transfer Act, where it is adopted, makes certificates of stock negotiable and protects a purchaser for value in good faith who takes even from a finder or a thief, provided the certificate is indorsed to the purchaser or indorsed in blank, i. e., to bearer.⁷⁰ It is provided by section 5: "The delivery of a certificate to transfer title in accordance with the provisions of Section 1, is effectual, except as provided in Section 7, though made by one having no right of possession and having no authority from the owner of the certificate or from the person purporting to transfer the title." Section 7 provides, "If the indorsement or delivery of a certificate,

(a) Was procured by fraud or duress, or

(b) Was made under such mistake as to make the indorsement or delivery inequitable; or

If the delivery of a certificate was made

(c) Without authority from the owner, or

(d) After the owner's death or legal incapacity, the possession of the certificate may be reclaimed and the transfer thereof rescinded, unless:

(1) The certificate has been transferred to a purchaser for value in good faith without notice of any facts making the transfer wrongful."

The purpose of this legislation, as also of the Bills of Lading Act, is to enable those dealing with certificates of stock or documents of title to rely upon them as reliable evidence of title. This facilitates business by making the circulation and transfer of property as easy, safe and certain as possible, and protecting purchasers and lenders in acting in reliance upon these documents which are the customary indicia of title. The security of a large amount of stock transfer, credit and banking business rests upon such evidence of title.⁷¹

⁶⁹ East Birmingham Land Co. v. Dennis, 85 Ala. 565, 5 So. 317, 2 L. R. A. 836, 7 Am. St. Rep. 73. See as to effect of custom, however, Baker v. Davie, 211 Mass. 429, 97 N. E. 1094; Casto v. Wrenn, — Mass. —, 150 N. E. 898.

⁷⁰ Uniform Stock Transfer Act, secs. 5, 7, Uniform State Laws, Annotated, Terry, p. 347. These sections give full negotiability to certi-

ficates of stock. Nicholson v. Morgan, 119 N. Y. Misc. 309, 196 N. Y. Supp. 147; Jenkins v. Continental Trust Co., — Md. —, 133 Atl. 610. *Bona fide* pledgee protected under Uniform Stock Transfer Act, although indorsement of stock was procured by fraud.

⁷¹ Ballantine, Purchase for Value, 6 Minnesota Law Rev. 87, 98; Warr

Quasi negotiability by application of the doctrine of estoppel.—

While certificates of stock are not negotiable instruments in any proper sense, the courts, in view of the extensive dealings in such securities, and the interest both of the public and of the corporations issuing them, in making them readily transferable and convertible, have, by application of the equitable doctrine of estoppel, clothed them with some of the characteristics of negotiable paper.⁷² As the New York court has said:⁷³ "While certificates of corporate stock lack some of the attributes of commercial paper and are, therefore, sometimes denominated only quasi-negotiable, yet parties who deal in them innocently have long been protected by the law upon an analogous principle. Nearly half a century ago the Supreme Court of the United States said in reference to such instruments: 'It is no less the interest of the shareholder, than the public, that the certificate representing his stock should be in a form to secure public confidence, for without this he could not negotiate it to any advantage. It is in obedience to this requirement, that stock certificates of all kinds have been constructed in a way to invite the confidence of business men, so that they have become the basis of commercial transactions in all the large cities of the country, and are sold in open market the same as other securities. Although neither in form or character negotiable paper, they approximate to it as nearly as practicable.'⁷⁴

"As was said by the same court in *National Safe Deposit, Savings & Trust Co. v. Hibbs*,⁷⁵ these principles are well known to business men and are constantly acted upon by them. So where the owner of stock in a corporation places his stock certificates indorsed in blank in the hands of another to dispose of them for

v. Collector of Taxes, 234 Mass. 279, 281, 125 N. E. 557.

⁷² *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325; *Knox v. Eden Musee Americain Co.*, 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; *Rough v. Breitung*, 117 Mich. 48, 75 N. W. 147; *Masury v. Arkansas Nat. Bank*, 93 Fed. 603; *Cook, Corporations* (8th Ed.), secs. 416, 767; *Fuller v. Glyn, Mills & Co.*, [1913] K. B. Div. —, 110 The Law Times 319: "A person who signs the transfer and hands the certificate to another person, knows that he is putting into the power and disposition of that person a document which carries with it an apparent authority

to that person to deal with it. So a person who allows a certificate indorsed in blank to remain in a broker's possession, enables the broker to deal with it by a representation of title or authority."

⁷³ *Union Trust Co. v. Oliver*, 214 N. Y. 517, 523, 524, 108 N. E. 809; *Cook, Corporations*, sec. 412. Voting trust certificate is negotiable like the stock which it represents. Owner estopped against pledgee from one intrusted with it duly indorsed.

⁷⁴ *First Nat. Bank of South Bend v. Lanier*, 11 Wall. (U. S.) 369, 377, 20 L. Ed. 172.

⁷⁵ 229 U. S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818.

a prescribed purpose and the agent, disregarding the direction of his principal, pledges the certificates as a security for a loan to himself, the owner is estopped from denying the lien acquired by the pledgees providing they acted in good faith and without notice of any limitation upon the authority of the agent.''

A purchaser of a certificate of stock in good faith and for value takes the stock free from any secret trusts or latent equities in favor of the corporation, or of prior parties in the line of transmission, or of third persons.⁷⁶ And, as we shall see in another section, the owner of a certificate of stock may be estopped to assert his title as against a *bona fide* purchaser from one whom he has clothed with apparent title or authority to transfer the stock.⁷⁷ This rule, however, is not based upon any idea that certificates of stock are negotiable instruments, but upon the doctrine of equitable estoppel.⁷⁸

In order that a purchaser or pledgee of stock may acquire a title free from secret liens in favor of the corporation, or latent equities between prior parties, he must be in the position of a *bona fide* purchaser for value. He takes subject to such liens or equities if he has notice of them at the time of his purchase, or notice of facts sufficient to put him on inquiry, or if he is not a purchaser for value.⁷⁹ Transferees of certificates of stock are chargeable with notice of all provisions or recitals therein, and of all facts as to which they are thereby put upon inquiry.⁸⁰

⁷⁶ *Dodds v. Hills*, 2 Hem. & M. 424; *Loring v. Salisbury Mills*, 125 Mass. 138; *Knox v. Eden Musee Americain Co.*, 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; *Masury v. Arkansas Nat. Bank*, 93 Fed. 603.

If one holds stock in trust, a purchaser in good faith will be protected, although the transferor is guilty of a breach of trust. *Winter v. Montgomery Gas-Light Co.*, 89 Ala. 544, 7 So. 773; *Dueber Watch Case Mfg. Co. v. Daugherty*, 62 Ohio St. 589, 57 N. E. 455; 14 *Corpus Juris* 785; *Shropshire Co. v. The Queen*, L. R. 7 H. of L. 496. See also, *Wolf v. Trust & Savings Bank*, 214 Fed. 761; *Ironstone Ditch Co. v. Equitable Securities Co.*, 52 Colo. 268, 273, 121 Pac. 174. Compare, however, *Colonial Bank v. Cady*, L. R. 51, App. Cas. 267; *Ireland v. Hart*, [1902] 1 Ch. 522.

⁷⁷ See post, § 150.

⁷⁸ See *East Birmingham Land Co. v. Dennis*, 85 Ala. 565, 5 So. 317, 26 L. R. A. 836, 7 Am. St. Rep. 73; *Baker v. Davie*, 211 Mass. 429, 97 N. E. 1094, 37 L. R. A. (N. S.) 944.

⁷⁹ *Vansands v. Middlesex County Bank*, 26 Conn. 144; *Jennings v. Bank of California*, 79 Cal. 323, 21 Pac. 852, 5 L. R. A. 233, 12 Am. St. Rep. 145; *Tecumseh Nat. Bank v. Russell*, 50 Neb. 277, 69 N. W. 763; *Bronson Elec. Co. v. Rheubottom*, 122 Mich. 608.

The weight of authority is that one who takes a stock certificate as security for an existing debt, without promise of extension or other present consideration is not protected as a purchaser for value. *Commercial Nat. Bank v. Shriver*, 275 Fed. 12, 15; 14 C. J. 736; 7 R. C. L. 214, 278; *Millard v. Green*, 94 Conn. 597, 110 Atl. 177, 9 A. L. R. 1610.

⁸⁰ *Jennings v. Bank of California*, 79 Cal. 323, 21 Pac. 852, 12 Am. St.

§ 150. Estoppel of true owner against bona fide purchaser.—A bona fide purchaser of a certificate of stock under a forged or unauthorized assignment, or from one who has stolen the same after its being indorsed in blank, acquires no title or right as against the true owner, unless the latter is estopped by his acts or negligence from asserting his title.

But the owner of a certificate of stock is estopped to assert his title as against a bona fide purchaser or pledgee from one whom he has intentionally or through negligence clothed with the apparent title, or with the apparent power to transfer the same.

If a corporation, although in good faith and without negligence, recognizes and registers a transfer of stock under a forged or unauthorized assignment, or otherwise without authority from the owner, and the latter is not estopped, it may be compelled to replace the stock on its books, or to pay the damages sustained by the true owner; and it will also become liable to an innocent purchaser of a new certificate issued on the basis of a forged indorsement.

Since certificates of stock are not negotiable instruments, it follows that a transfer of a certificate of stock, even to a *bona fide* purchaser or pledgee, by one who has no title or authority to transfer the same, gives the transferee no title to the shares as against the true owner, unless the latter is for some reason estopped to assert his title⁸¹ “The general rule of the law,” said Lord Herschell in an English case, “is, that where a person has obtained the property of another from one who is dealing with it without the authority of the true owner, no title is acquired as against that owner, even though full value be given, and the property be taken in the belief that an unquestionable title thereto is being obtained, unless the person taking it can show that the

Rep. 145; Vansands v. Middlesex County Bank, 26 Conn. 144; Stafford v. Produce Exch. Banking Co., 61 Ohio St. 160, 55 N. E. 162, 76 Am. St. Rep. 371.

⁸¹ National Safe Deposit Savings & Trust Co. v. Hibbs, 229 U. S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818; Hildyard v. South Sea Co., 2 P. Wms. 76; Colonial Bank v. Cady, 15 App. Cas. 267; Western U. Tel. Co. v. Davenport, 97 U. S. 369, 24 L. Ed. 1047; Bangor Elec. Light & Power Co. v. Robinson, 52 Fed. 520; East Birmingham Land Co. v. Dennis, 85

Ala. 565, 5 So. 317, 26 L. R. A. 836, 7 Am. St. Rep. 73; Barstow v. Savage Min. Co., 64 Cal. 388, 1 Pac. 349, 49 Am. Rep. 705; Taft v. Presidio & Ferries R. Co., 84 Cal. 131, 24 Pac. 436, 11 L. R. A. 125, 18 Am. St. Rep. 166; Pollock v. National Bank, 7 N. Y. 274, 57 Am. Dec. 520; Mechanics' Bank v. New York & N. H. R. Co., 13 N. Y. 599; Westinghouse v. German Nat. Bank of Pittsburgh, 188 Pa. St. 630, 41 Atl. 734; O'Herron v. Gray, 168 Mass. 573, 47 N. E. 429, 60 Am. St. Rep. 411, 40 L. R. A. 498.

true owner 'has so acted as to mislead him into the belief that the person dealing with the property had authority to do so. If this can be shown, a good title is acquired by personal estoppel against the true owner.'"⁸²

In accordance with this principle, it has repeatedly been held that a *bona fide* purchaser or pledgee of a certificate of stock acquires no title thereto where he takes the same under a forged assignment and power of attorney. This is true, not only where the certificate is lost or stolen, and the assignment and power of attorney is forged by the finder or thief, but also where the forgery is committed by one to whom the certificate has been intrusted as agent or bailee.⁸³ The same principle applies where an assignment of a certificate of stock is indorsed thereon by a person without any authority or apparent authority from the owner, although without any fraudulent intent.⁸⁴

Pomeroy lays it down in his work on Equity Jurisprudence, sec. 712, that even where a transfer of a certificate of stock is accomplished solely by the forgery of the owner's name to the indorsement and power of attorney, and the certificate thus comes into the hands of a purchaser for valuable consideration and without notice, and he registers himself as a stockholder by surrendering the original certificate to the corporation and receiving a new one in his own name, the purchaser would be protected. He asserts that the assignee would under these circumstances obtain a complete precedence over the original owner; he would not be liable to the owner for the shares nor for their value; the owner's remedy, if it exists at all, is against the corporation alone, to compel it either to issue new shares or to pay the value of the old ones. This remarkable statement is, however, not supported by the authorities cited by Mr. Pomeroy, and seems clearly erroneous. It is only where one purchases stock from one who is registered on the company's books as legal owner that he prevails by estoppel. No estoppel against the corporation is created in favor of the person presenting stock with a forged transfer by the issue to him of a

⁸² London Joint Stock Bank v. Simmons, [1892] App. Cas. 201, 215.

⁸³ Hildyard v. South Sea Co., 2 P. Wms. 76; Ashby v. Blackwell, Ambler, 503, 2 Eden 299; Simm v. Anglo-American Tel. Co., 5 Q. B. Div. 188; Western U. Tel. Co. v. Davenport, 97 U. S. 369, 24 L. Ed. 1047;

Pratt v. Taunton Copper Mfg. Co., 123 Mass. 110, 25 Am. Rep. 37; Pollock v. National Bank, 7 N. Y. 274, 57 Am. Dec. 520.

⁸⁴ Sewall v. Boston Water Power Co., 4 Allen (Mass.) 277, 81 Am. Dec. 701.

new certificate.⁸⁵ If the corporation has registered the transferee whose title is based on a forgery, it may cancel his stock.⁸⁶

When a forged or unauthorized transfer of a certificate of stock is presented to the corporation for transfer on its books and the issue of a new certificate, and the corporation recognizes the transfer and issues a new certificate to the transferee, it is not estopped to deny the validity of the new certificate as against him, for he has parted with his money in reliance, not on such certificate, but on the forged or unauthorized transfer, for which the corporation is not responsible. He is not in any way injured, therefore, by the act of the corporation in recognizing the transfer and issuing the new certificate.^{86a}

Even where a lost or stolen certificate had been indorsed in blank by the person appearing on the books of the corporation as owner, a *bona fide* transferee from the finder or thief acquires no title as against the true owner, unless the latter has been guilty of such negligence as will estop him from asserting his title.⁸⁷ Thus certificates of stock duly indorsed were surrendered to a corporation for transfer and new certificates were issued, the old certificates being put in a safe uncanceled. They were taken wrongfully by an employee from the safe and pledged to a *bona fide* taker. The corporation was held not liable to the pledgee as the employee was a thief, not one entrusted with the indicia of title.⁸⁸

⁸⁵ Hamilton v. Central Ohio N. Co., 44 Md. 551; Brown v. Howard Fire Ins. Co., 42 Md. 384; Houston v. Van Alstyne, 56 Tex. 439. See note 21 Columbia Law Rev. 576. See post, § 151.

⁸⁶ Citizens' Nat. Bank v. State ex rel. Kellogg, 179 Ind. 621, 631, 635, 101 N. E. 620, 45 L. R. A. (N. S.) 1075, 1077, 1082.

^{86a} Simm v. Anglo-American Telegraph Co., 5 Q. B. 188. See post, § 151, note 110.

⁸⁷ National Safe Deposit, Savings & Trust Co. v. Hibbs, 229 U. S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818; East Birmingham Land Co. v. Dennis, 85 Ala. 565, 5 So. 317, 26 L. R. A. 836, 7 Am. St. Rep. 73; Bangor Elec. Light & Power Co. v. Robinson, 52 Fed. 520; Barstow v. Savage Min. Co., 64 Cal. 388, 1 Pac. 349, 49 Am. Rep. 705; Knox v. Eden Musee Americain Co., 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 799, 51 Am. St. Rep. 700; O'Herron v. Gray, 168 Mass.

573, 47 N. E. 429, 60 Am. St. Rep. 411; Barstow v. City Trust Co., 216 Mass. 330, 103 N. E. 911; Schumacher v. Greene Cananea Copper Co., 117 Minn. 124, 134 N. W. 510, 38 L. R. A. (N. S.) 180, Ann. Cas. 1913 C 1115; Farmers' Bank v. Diebold Safe and Lock Co., 66 Ohio St. 367, 64 N. E. 518, 58 L. R. A. 620, 90 Am. St. Rep. 586.

⁸⁸ Knox v. Eden Musee Americain Co., 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 799, 51 Am. St. Rep. 700; East Birmingham Land Co. v. Dennis, 85 Ala. 565, 5 So. 317, 26 L. R. A. 836. A stock certificate was issued to D who indorsed it in blank. The certificate was kept in a safe deposit box at a bank. It was abstracted without any fault on D's part and transferred to M, who bought in good faith and paid value. It was held that M got no title, as certificate is not negotiable, but only a *muniment* of title or evidence of the holder's right.

Estoppel of true owner to assert title as against transferee.—

The doctrine that a *bona fide* purchaser of shares under a forged or unauthorized transfer acquires no title as against the true owner does not apply where the circumstances are such as to estop the latter from asserting his title. Such an estoppel may arise either from entrusting another with certificates duly indorsed or from negligence. It is a well-settled principle that, where the owner of property clothes another with apparent title to the same, or apparent authority to dispose of the same, he will be estopped to deny such apparent title or authority as against third persons dealing with the other party on the faith thereof. And in accordance with this principle, it has repeatedly been held that the owner of shares is estopped from asserting his title as against a *bona fide* purchaser or pledgee of the shares from one whom he has clothed with apparent title thereto, or with apparent authority to transfer the same, as by delivering him the certificate indorsed either to him or in blank.⁸⁹

If an owner of stock enables another to appear to be owner or to have full power of disposition, an innocent purchaser will have a superior equity. One who, for purposes of his own, places the apparent legal title to property in another must take the risk of loss that may result from his dealing with innocent third persons as owner. Where, however, an agent or servant or other person simply has access to a document indorsed in blank, remaining in the

⁸⁹ *Knox v. Eden Musee Americain Co.*, 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325, 7 Am. Rep. 341; *Walker v. Detroit Transit Ry. Co.*, 47 Mich. 338; *Mount Holly, L. & M. Turnpike Co. v. Ferree*, 17 N. J. Eq. 117; *Prall v. Tilt*, 28 N. J. Eq. 479; *Otis v. Gardner*, 105 Ill. 436; *Colonial Bank v. Cady*, 15 App. Cas. 267. See also, *Masury v. Arkansas Nat. Bank*, 93 Fed. 603, rev'g 87 Fed. 381; *Brittan v. Oakland Bank of Savings*, 124 Cal. 282, 57 Pac. 84, 71 Am. St. Rep. 58; *Gilbert v. Erie Building Ass'n*, 184 Pa. St. 554, 39 Atl. 291; *Westinghouse v. German Nat. Bank*, 196 Pa. St. 249, 46 Atl. 380; *National Safe Deposit, Savings & Trust Co. v. Hibbs*, 229 U. S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818; *National City Bank v. Wagner*, 216 Fed. 473; *O'Neil v. Wolcott Min. Co.*, 174 Fed. 527, 27 L. R. A.

(N. S.) 200; *Baker v. Davie*, 211 Mass. 429, 97 N. E. 1094, 37 L. R. A. (N. S.) 944; *Austin v. Hayden*, 171 Mich. 38, 137 N. W. 317, Ann. Cas. 1915 B 894.

In *Baker v. Davie*, supra, *Rugg, C. J.*, says: "If the owner of stock knowingly places in the hands of another the certificate therefor, either indorsed in blank or by a separate instrument of transfer and power of attorney, the person to whom the certificate and instrument are delivered can pass a good title by delivery or pledge regardless of the relations between him and the owner. . . . This is on the ground of estoppel, because the owner having given another such indicia of title as clothes him with the appearance of ownership is precluded from setting up title in himself as against a holder in good faith."

possession of the owner, and the owner has not intrusted him with the document, he is not considered to have done enough to be estopped against a purchaser in good faith.⁹⁰ The owner of shares of stock is not guilty of negligence in merely intrusting another with the possession of his certificate of stock, if he does not, by assignment or otherwise, clothe him with the apparent title.⁹¹

It has been held in effect that intrusting a servant or agent with the custody of certificates of stock assigned in blank, without any authority to deal with the same, is not such negligence as to estop the owner from reclaiming the same from a *bona fide* purchaser from the agent or servant, since an employer or master is not to be deemed guilty of negligence because he does not anticipate and provide against possible criminal acts of his servants or employees.⁹² But the soundness of this view is doubtful, to say the least. If the certificates are intrusted with blank assignments and power to make transfers to brokers or an attorney for safe-keeping, without authority to sell, the owner should suffer the loss by betrayal of the confidence rather than innocent purchasers who were misled.⁹³

⁹⁰ *Hudson Trust Co. v. American Linseed Co.*, 232 N. Y. 350, 134 N. E. 178, note, 31 Yale Law Journal 773; *Knox v. Eden Musee Co.*, 148 N. Y. 441, 454, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; *Bangor Elec. Light & Power Co. v. Robinson*, 52 Fed. 520. Robinson got certificate indorsed in blank. He put it in deposit box held in common with W, a broker who abstracted it and pledged it to Lee for money borrowed. In interpleader, held: Robinson is entitled to be registered as stockholder and not Lee, the *bona fide* pledgee.

⁹¹ *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325, 1 Am. Rep. 341; *Colonial Bank v. Cady*, 15 App. Cas. 267; *Western U. Tel. Co. v. Davenport*, 97 U. S. 369, 24 L. Ed. 1047; *Shattuck v. American Cement Co.*, 205 Pa. 197, 54 Atl. 785, 97 Am. St. Rep. 735. See *Paine, Webber & Co. v. Arkansas & Arizona Copper Co.*, 136 Ark. 385, 206 S. W. 447; *Casto v. Wrenn*, — Mass. —, 150 N. E. 898.

⁹² *Knox v. Eden Musee American Co.*, 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; *Hall v. Wagner*, 111 N. Y. App. Div. 70, 97 N. Y. Supp. 570; *Pennsylvania Co. v. Franklin Fire Ins. Co.*, 181

Pa. St. 40, 37 Atl. 191, 37 L. R. A. 780; *Western U. Tel. Co. v. Davenport*, 97 U. S. 369, 24 L. Ed. 1047; *Scollans v. Rollins*, 173 Mass. 275, 53 N. E. 863, 73 Am. St. Rep. 248; s. c., 179 Mass. 346, 60 N. E. 983, 88 Am. St. Rep. 386.

⁹³ *National Safe Deposit, Savings & Trust Co. v. Hibbs*, 229 U. S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818; *National City Bank v. Wagner*, 216 Fed. 473, 480; *Shattuck v. American Cement Co.*, 205 Pa. 197, 54 Atl. 785, 97 Am. St. Rep. 735; *O'Mara v. Newcomb*, 38 Colo. 275, 88 Pac. 167. See *American Nat. Bank v. Dew*, 175 N. O. 79, 94 S. E. 708; *Russell v. American Bell Tel. Co.*, 180 Mass. 467, 62 N. E. 751.

In a leading New York case plaintiff pledged certificate indorsed in blank with his brokers for a margin on account of advances. The brokers repledged with defendant for larger amount. *Held*, plaintiff can only get certificate from defendant on payment of amount for which the broker pledged to defendant, as the broker was clothed with indicia of ownership. *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325, 7 Am. Rep. 341. See 14 C. J., pp. 783, 786.

In *Schumacker v. Greene-Cananea Copper Co.*,⁹⁴ the plaintiff, owner of a stock certificate, indorsed it in blank to a reputable going bank as pledge for a loan. The cashier stole it and sold it to a *bona fide* purchaser. It was held that the owner was not estopped to assert his title against the innocent purchaser. It is admitted that if the sale was the act of the bank, the defendant should prevail, as the plaintiff was the one who trusted the bank and put in its hands the power of inflicting the loss. But it was held that the cashier's act in abstracting and selling the certificate was not the act of the pledgee bank, but of the officer individually. In view of the fact that there was authority to the cashier to sell in case of default, and that the certificate was indorsed in blank for that purpose, it is somewhat hard to understand why the act of the cashier was not the act of the bank, and why pledging a certificate in blank to a bank should not raise an estoppel as much as pledging it to a broker by way of a margin. The cashier has powers which give him something more than mere access to the safe or strong box of the bank. Differentiating between "access" and "intrusting" in the case of corporate officers is very technical, as a corporation cannot have possession or do anything except by its agents and officers. These decisions make the public guarantee the honesty of corporate officials rather than the corporation.

However this may be, it is clear that the mere indorsement of an assignment and power of attorney in blank on a certificate of stock, which is afterwards lost or stolen, is not such negligence as will estop the owner from asserting his title as against a *bona fide* purchaser from the finder or thief, or from holding the corporation liable for allowing a transfer on its books, where the loss or theft of the certificate was not due to any negligence on the part of the owner.⁹⁵ A person is not guilty of negligence in leaving a certificate of stock indorsed in blank in a safe-deposit box used by

⁹⁴ 117 Minn. 124, 134 N. W. 510, 38 L. R. A. (N. S.) 180, Ann. Cas. 1913 C 1115. See acc. *Barstow v. City Trust Co.*, 216 Mass. 330, 103 N. E. 911, note, 62 Univ. of Pa. Law Rev. 635. But see *McCarthy v. Crawford*, 238 Ill. 38, 86 N. E. 750, 29 L. R. A. (N. S.) 252, 254, 128 Am. St. Rep. 95; *National Safe Deposit, Savings & Trust Co. v. Hibbs*, 229 U. S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818; *Lynch v. International Banking Corp.*, 68 Cal. App. 432, 229 Pac. 968.

⁹⁵ *Biddle v. Bayard*, 13 Pa. St. 150;

East Birmingham Land Co. v. Dennis, 85 Ala. 565, 5 So. 317, 2 L. R. A. 836, 7 Am. St. Rep. 73; *Barstow v. Savage Min. Co.*, 64 Cal. 388, 1 Pac. 349, 49 Am. Rep. 705; *Bangor Elec. Light & Power Co. v. Robinson*, 52 Fed. 520; *Knox v. Eden Musee American Co.*, 148 N. Y. 441, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700; *O'Herron v. Gray*, 168 Mass. 573, 47 N. E. 429, 40 L. R. A. 498, 60 Am. St. Rep. 411. Compare note 70, ante.

himself and a stock-broker jointly, so as to be estopped from asserting his title after the certificate has been stolen by the other, and sold or pledged to a *bona fide* purchaser or pledgee.⁹⁶

Purchasers or pledgees with notice—Circumstances putting them on inquiry.—The doctrine that the owner of shares is estopped to assert his title as against a purchaser or pledgee from one whom he has clothed with apparent title or authority clearly does not apply in favor of purchasers or pledgees who have actual notice that the apparent title or authority is not real.⁹⁷ Nor does the doctrine apply where the form or terms of the indorsement on the certificate or the other circumstances are sufficient to put the purchaser or pledgee upon inquiry.⁹⁸

False representation of authority.—The doctrine that the owner of shares of stock, who allows another to appear as owner of his certificate, is estopped to assert his title as against a *bona fide* purchaser or pledgee from the latter, does not apply where the person in possession of the certificate does not assume to transfer the certificate as owner, but assumes to act as agent of the owner, and falsely represents that he has authority from the latter to sell or pledge the same. In such a case, the owner is not estopped as against the purchaser or pledgee, unless he has held the transferrer out as having authority to so act for him; and the fact that he has clothed the transferrer with apparent title to the stock, so that he would be estopped if the latter had transferred the same as owner, is immaterial.⁹⁹

§ 151. Remedies in the case of forged or unauthorized transfers.

The remedies of the various parties in the case of a forged or unauthorized transfer of a certificate of stock depend upon the circumstances. The party seeking relief may be the true owner of the stock, or the corporation, or the transferee.

⁹⁶ Bangor Elec. Light & Power Co. v. Robinson, 52 Fed. 520. See Hudson Trust Co. v. American Linseed Co., 232 N. Y. 350, 134 N. E. 178.

⁹⁷ Westinghouse v. German Nat. Bank of Pittsburg, 188 Pa. St. 630, 41 Atl. 734; Davis v. Finch, 236 Fed. 89; Austin v. Hayden, 171 Mich. 38, 137 N. W. 317, Ann. Cas. 1915 B 894.

⁹⁸ Davis v. Finch, 236 Fed. 89; Colonial Bank v. Cady, 15 App. Cas.

267; Anderson v. Nicholas, 28 N. Y. 600; Treadwell v. Clark, 190 N. Y. 51, 82 N. E. 505; Northwestern Portland Cement Co. v. Atlantic Portland Cement Co., 174 Cal. 308, 163 Pac. 47; Hyatt v. First Nat. Bank, 193 Iowa 593, 187 N. W. 949.

⁹⁹ Merchants' Bank of Canada v. Livingston, 74 N. Y. 223; Fletcher, Corporations, sec. 3836.

Remedies of owner against the corporation.—If a corporation recognizes a forged or unauthorized assignment of a certificate of stock and power of attorney to transfer the same, and registers the transfer on its books, or if it registers a transfer without any assignment or authority from the owner, what is the effect upon the rights of the owner whose certificate has been surrendered and canceled, and who is no longer registered as a stockholder upon the books of the company? The true owner of the shares cannot be deprived of his rights by forgery or unauthorized transfer. He may sue the corporation for damages for conversion of the shares.¹⁰⁰ Instead of suing at law for conversion, the owner of stock which has been transferred by the corporation on its books under a forged or unauthorized assignment may maintain a suit in equity to compel the corporation to replace the shares on its books in his name, and issue to him a proper certificate, or, in the alternative, to recover a judgment for their value.¹⁰¹ If the shares still stand on the books of the corporation in the name of the person from or through whom the plaintiff acquired title, he may sue to compel the corporation to transfer the same to him on its books, and to issue him a new certificate, making the claimant under the forged or unauthorized transfer a party defendant.¹⁰²

Unless the true owner of the stock is estopped by his negligence, the fact that the corporation acted in good faith and without negligence in recognizing and registering a forged or unauthorized transfer is no defense as against the true owner. It is bound at its peril to ascertain whether an assignment and power of at-

¹⁰⁰ *Herbert Kraft Co. v. Bank of Orland*, 133 Cal. 64, 65 Pac. 143; *Taft v. Presidio & Ferries R. Co.*, 84 Cal. 131, 24 Pac. 426, 11 L. R. A. 125, 18 Am. St. Rep. 166; *Pollock v. National Bank*, 7 N. Y. 274, 57 Am. Dec. 520; *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648, 20 Am. St. Rep. 467; *Caulkins v. Gas-Light Co.*, 85 Tenn. 683, 4 S. W. 287, 4 Am. St. Rep. 786; *Geyser-Marion Gold-Mining Co. v. Stark*, 106 Fed. 558, 53 L. R. A. 684; *Chicago Edison Co. v. Fay*, 164 Ill. 323, 45 N. E. 534; *Hughes v. Drovers' & Mechanics' Nat. Bank*, 86 Md. 418, 38 Atl. 936; *Casper v. Kalt-Zimmers Mfg. Co.*, 159 Wis. 517, 149 N. W. 754, 150 N. W. 1101. And see *Harrison v. Pryse*, Barn. Ch. 324; *Mackenzie v. A. Engelhard & Sons Co.*, 266 U. S. 131, 69 L. Ed. 205, 45

Sup. Ct. 68, 36 A. L. R. 416, noted in *Harvard Law Rev.* 828.

¹⁰¹ *Western U. Tel. Co. v. Davenport*, 97 U. S. 369, 24 L. Ed. 1047; *Walker v. Detroit Transit Ry. Co.*, 47 Mich. 338, 11 N. W. 187; *Brown v. Howard Fire Ins. Co.*, 42 Md. 384, 20 Am. Rep. 90; *Pratt v. Taunton Copper Mfg. Co.*, 123 Mass. 110, 25 Am. Rep. 37; *Pratt v. Boston & Albany R. Co.*, 126 Mass. 443; *Hildyard v. South Sea Co.*, 2 P. Wms. 76; *Ashby v. Blackwell, Ambler*, 503, 2 Eden 299; *Chicago Edison Co. v. Fay*, 164 Ill. 323, 45 N. E. 534; *Snyder v. Charleston & S. B. Co.*, 65 W. Va. 1, 63 S. E. 616, 131 Am. St. Rep. 947.

¹⁰² *Barstow v. Savage Min. Co.*, 64 Cal. 388, 1 Pac. 349, 49 Am. Rep. 705; *East Birmingham Land Co. v. Dennis*, 85 Ala. 565, 5 So. 317, 2 L. R. A. 836, 7 Am. St. Rep. 73.

torney purporting to have been executed by the owner of stock is genuine.¹⁰³ But where a corporation acts in good faith and without negligence in allowing a transfer by one who appears to be the absolute owner of shares, it is not liable to one having a mere equitable title by virtue of a prior unregistered transfer, or otherwise, of which it has no notice.¹⁰⁴ It is liable, however, if it has actual notice of the equitable title, or if the form of the certificate or other circumstances are sufficient to put it upon inquiry.¹⁰⁵

Liability of transferees to true owner.—When certificates of stock have been transferred under a forged assignment and power of attorney, or when they have been lost or stolen, without negligence, after having been indorsed or assigned in blank, and have been transferred by the finder or thief, the true owner may recover the certificate from the transferee or any subsequent transferee; or he may join him in a suit against the corporation to compel a transfer or retransfer on its books, according to the circumstances.¹⁰⁶ Or he may maintain an action for conversion against the transferee to recover the value of the stock, even after the latter has sold and transferred the same to another.¹⁰⁷ But the owner of shares which have been transferred by the corporation on its books under a forged power of attorney has no right of action against a *bona fide* purchaser of the shares who purchased, not the original certificates, but a new certificate issued by the corporation.¹⁰⁸

¹⁰³ *Western U. Tel. Co. v. Davenport*, 97 U. S. 369, 24 L. Ed. 1047. See also, *Caulkins v. Gas-Light Co.*, 85 Tenn. 683, 4 S. W. 287, 4 Am. St. Rep. 786.

¹⁰⁴ *Loring v. Salisbury Mills*, 125 Mass. 138; *Leurey v. Bank of Baton Rouge*, 131 La. 30, 58 So. 1022, Ann. Cas. 1913 E 1168.

While a corporation is bound to protect its stockholders against unauthorized transfers by requiring satisfactory evidence of authority to transfer, it is not bound, where the power to transfer appears, to inquire whether the transferrer is attempting a fraud. *Hughes v. Drovers' & Mechanics' Nat. Bank*, 86 Md. 418, 38 Atl. 936.

¹⁰⁵ *Loring v. Salisbury Mills*, 125 Mass. 138; *Shaw v. Spencer*, 100 Mass. 382, 97 Am. Dec. 107, 1 Am.

Rep. 115; *Mackenzie v. A. Engelhard & Sons Co.*, 266 U. S. 131, 69 L. Ed. 205, 45 Sup. Ct. 68, 36 A. L. R. 416.

¹⁰⁶ *Hildyard v. South Sea Co.*, 2 P. Wms. 76; *East Birmingham Land Co. v. Dennis*, 85 Ala. 565, 5 So. 317, 2 L. R. A. 836, 7 Am. St. Rep. 73; *State ex rel. Louisiana State Bank v. Bank of Baton Rouge*, 125 La. 138, 51 So. 95, 136 Am. St. Rep. 332.

¹⁰⁷ *Monk v. Graham*, 8 Mod. 9; *Harrison v. Pryse, Barn. Ch.* 324; *Bereich v. Marye*, 9 Nev. 312; *Anderson v. Nicholas*, 28 N. Y. 600; *Reichard v. Hutton*, 158 N. Y. App. Div. 122, 142 N. Y. Supp. 935.

¹⁰⁸ *Pratt v. Taunton Copper Mfg. Co.*, 123 Mass. 110, 25 Am. Rep. 37; *Winter v. Montgomery Gas-Light Co.*, 89 Ala. 544, 7 So. 773. See *Fletcher, Corporations*, sec. 3848.

Liability of corporation to the transferee in case of forged or unauthorized transfer.—A person who is defrauded by a forged or unauthorized transfer has his remedy, of course, against the transferrer. He also has a right of action against the corporation if there was collusion or fraud on its part, but not otherwise. In the absence of any fraud or collusion on the part of a corporation, the mere transfer of stock by it on its books to a purchaser by direction of the seller does not make the company liable as a guarantor of the seller's title to the stock.¹⁰⁹ A purchaser or pledgee of a certificate of stock upon which an assignment by the true owner has been forged, and who has surrendered the certificate to the company, and received from it a new certificate in lieu thereof, has no remedy against the corporation upon the true owner's recovering the certificate from him. The corporation incurs no liability to him by reason of its permitting the transfer under the forged assignment, for it is his responsibility to see that the indorsement was genuine.¹¹⁰ The holder of the new certificate takes it, not on the faith of any representation by the corporation, but on the faith of the forged indorsement and power of attorney. If the new certificate which the corporation has been induced to issue in reliance on the forged or unauthorized transfer is still in the hands of the person who procured its issuance, or is in the hands of a transferee from him who does not occupy the position of a *bona fide* purchaser for value, the corporation may repudiate the certificate, and maintain a suit in equity to compel its surrender or to cancel it. Issuing new certificates of stock on the faith of forged powers of transfer on the back of the original certificates creates no estoppel against the corporation in favor of the person presenting the forged power and obtaining the new certificate.¹¹¹

Rights of bona fide purchaser of new certificate.—This does not apply however, where the new certificate has passed into the

¹⁰⁹ Central Railroad & Banking Co. v. Ward, 37 Ga. 515.

¹¹⁰ Brown v. Howard Fire Ins. Co., 42 Md. 384, 20 Am. Rep. 90; Hambleton v. Central Ohio R. Co., 44 Md. 551; Trimble v. Wollman, 71 Mo. App. 467.

But where a new certificate is issued to the transferee of a forged certificate, and the transferee parts with value wholly on the faith of the new issue, the corporation may be liable on the new certificate. Trimble v.

Wollman, *supra*. See 2 Cook, Corporations (8th Ed.), secs. 370, 401; Machen, Corporations, secs. 914, 916, 942; Ewart, Estoppel, pp. 187, 188. See also ante, § 149.

¹¹¹ Brown v. Howard Fire Ins. Co., 42 Md. 384, 20 Am. Rep. 90; Hambleton v. Central Ohio R. Co., 44 Md. 551; Simm v. Anglo-American Telegraph Co., 5 Q. B. Div. 188; Hildyard v. South Sea Co., 2 P. Wms. 76. Contra, Ashby v. Blackwell, Ambler 503, 2 Eden 299.

hands of a *bona fide* purchaser for value. Where a corporation recognizes and registers a forged or unauthorized transfer, and issues a new certificate, although it may act in the most perfect good faith, it has no remedy against subsequent *bona fide* purchasers of the new certificate, for as against them it is estopped to deny the validity of the certificate. In such a case, the purchaser does not claim under the original certificate, or under the forged or unauthorized transfer of it, but claims under the new certificate issued by the corporation, and the corporation, since it is estopped to deny the validity of his certificate, cannot maintain an action to cancel the same.¹¹²

Ewart in his work on Estoppel¹¹³ analyzes the situation as follows: "A company inadvertently issues a certificate which untruthfully declares that A is the owner of certain shares. Upon the faith of this certificate some one purchases the shares. The company is now estopped from denying the purchaser's title. For remedy the purchaser cannot sue the company directly upon the misrepresentation in deceit, for there is no fraud. Nor can he insist on the company giving him shares for (as we may assume) all the authorized shares have been issued to others. His action is for damages for refusal to register him as a shareholder."

In *Re Bahia & S. F. Ry. Co.*,¹¹⁴ the company had accepted a transfer upon which the owner's name had been forged and issued new certificates to S & G which were sold to *bona fide* purchasers B & G. It was held that the purchasers, having in good faith acted upon the certificate issued to S & G that they were holders of these shares, on which certificate the company knew that persons wanting to purchase shares might act, they can recover the damages suffered thereby from the company, namely the value of

¹¹² *Machinist's Nat. Bank v. Field*, 126 Mass. 345; *Pratt v. Taunton Copper Mfg. Co.*, 123 Mass. 110, 25 Am. Rep. 37; *Mandlebaum v. North American Min. Co.*, 4 Mich. 465; In re *Bahia & S. F. Ry. Co.*, L. R. 3 Q. B. 584; *New York & N. H. R. Co. v. Schuyler*, 34 N. Y. 30; *Winter v. Montgomery Gas-Light Co.*, 89 Ala. 544, 7 So. 773; *Fletcher, Corporations*, sec. 3848. See ante, § 150.

¹¹³ Ewart, *Estoppel*, pp. 187, 188, 230, 234. "Nominally the cause of action in the case is the refusal of the company to register the shares, In

reality the cause of action is based upon misrepresentation."

¹¹⁴ L. R. 3 Q. B. 584. And see ante, § 149, notes 85, 86.

It is generally held that a person to whom the company is liable by estoppel to pay damages for refusing to register the transfer does not by reason of estoppel become a shareholder. *First Ave. Land Co. v. Parker*, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 841; *Balkis Consol. Co. v. Tomkinson* [1893] A. C. 396; *Fletcher, Corporations*, sec. 3848. But see *Machinist's Nat. Bank v. Field*, 126 Mass. 345,

the shares at the time the true owner interfered and claimed them from the plaintiffs.

The distinction then between the right of A, the *bona fide* purchaser from the forger and that of B the *bona fide* purchaser of the new certificate procured on the basis of the forged indorsement is this. A who surrenders the certificate with its forged indorsement and procures the issue of a new one to himself acquires no rights against the owner or against the corporation. The corporation has been induced to recognize him as shareholder by mistake and innocent misrepresentation. The shares still belong to the former owner. But if A, so accredited as stockholder by the corporation, transfers this certificate to B, an innocent purchaser, who buys in reliance upon the certificate of title issued by the corporation, the corporation will come under a liability by virtue of its innocent misrepresentation which has misled B to part with his money. It must restore the true owner to his rights and pay damages to B, the second purchaser. It may have a remedy against A for its loss, as we shall now see.

Remedies of the corporation in the case of forged or unauthorized transfers.—What is the remedy against the person by whom the corporation was induced to recognize and register the transfer? When a person holding a certificate of stock under a forged or unauthorized transfer presents the same to the corporation, and induces it to register the same, and issue to him a new certificate, he impliedly represents that his title is good, and the transfer genuine or authorized, and the corporation may maintain an action against him for any damages which it may sustain by reason of its liability to the true owner. And in such a case the fact that he acted in good faith, and in the belief that the transfer of the original certificate was genuine or authorized, is immaterial.¹¹⁵

In *Sheffield Corp. v. Barclay*,¹¹⁶ the facts were that B and C in good faith forwarded to the S Corporation a transfer of its stock which purported to be executed by the registered holders. The corporation registered the stock in the name of B and Company and issued new certificates to B and Company who trans-

¹¹⁵ *Boston & A. R. Co. v. Richardson*, 135 Mass. 473; *Boston Tow Boat Co. v. Medford Nat. Bank*, 232 Mass. 38, 121 N. E. 491; *Brown v. Howard Fire Ins. Co.*, 42 Md. 384, 20 Am. Rep. 90; *Simm v. Anglo-American Telegraph Co.*, 5 Q. B. Div. 188.

Contra, *Ashby v. Blackwell, Ambler* 503, 2 Eden 299. See *Friedman*, 40 *American Law Rev.* 496; *Mechem*, 18 *Green Bag* 46, 47; *Thorndyke*, 17 *Harvard Law Rev.* 373, 543.

¹¹⁶ [1905] *A. C.* 392; 18 *Green Bag* 46, 47.

ferred them for value to third parties. Later the transfer proved to be a forgery, and the corporation sued B and Company for indemnity against the liability which it had incurred. The House of Lords decided for the corporation on the principle that where a person under a duty of a ministerial character (like the duty of transferring stock on the books of the company) is called upon to exercise that duty on the request or demand of another, there is implied by law a contract by the person making the request to keep indemnified the person having the duty against any liability which may result from such exercise of the supposed duty. The contract to be implied from the circumstances is not only a warranty of title, but also an agreement to keep the corporation indemnified against any loss resulting to them from the transaction.

In *Boston Tow-Boat Co. v. Medford Nat. Bank*,¹¹⁷ the court denied that the true basis of liability of the transferer is an implied contract of indemnification from the innocent presentation of a forged transfer by the purchaser of stock. The liability arises from the implied representation that the transfer is valid giving rise to an implied warranty. Such warranty is broken upon the issue by the corporation of the new certificate, and the statute of limitations will run from that date, whereas if it were a contract to indemnify the statute would not begin to run until the loss or damage was suffered.

Liability of person selling stock as broker or agent.—It is a general principle that a person who acts as agent in selling property for one who has no title, although he acts in good faith, is guilty of a conversion, and therefore a stockbroker or other agent, who sells certificates of stock received by him for sale from one who has stolen them, is guilty of conversion of the stock, and liable therefor to the true owner, although the thief may have represented himself to be the owner, and the broker or agent may have acted in good faith, and may have paid the proceeds over to the thief.¹¹⁸ But a stockbroker who in good faith sells for a customer a nego-

¹¹⁷ 232 Mass. 38, 121 N. E. 491. See Warren, 34 Harvard Law Rev. 305; *Coal & Navigation Co. v. Blakelee*, 189 Pa. 13, 41 Atl. 992.

It seems correct to say that it is not a question of implied contract, but of obligation imposed by law upon the basis of a representation made to induce the corporation to act for the transferor's benefit. The transferee had no title and he obtained a

certificate from the corporation on the basis that he had title to the shares and derived a benefit thereby. The law therefore may justly place upon him full responsibility for the consequences.

¹¹⁸ *Kimball v. Billings*, 55 Me. 147, 92 Am. Dec. 581; *Swim v. Wilson*, 90 Cal. 126, 27 Pac. 33, 13 L. R. A. 605, 25 Am. St. Rep. 110; *Bercich v. Marye*, 9 Nev. 312.

liable bond payable to bearer and pays over the proceeds is not liable in tort for conversion to the true owner of the bond from whom it was stolen.¹¹⁹

§ 152. Unauthorized or fraudulent transfers by trustees.—A bona fide purchaser of stock from one who appears on the books of the corporation or the certificate to be the absolute owner thereof acquires a good title, although the seller may in fact have held the stock in trust, and the transfer may have been unauthorized or fraudulent. But it is otherwise if he had actual or constructive notice of the trust, and the circumstances surrounding the transfer were such as to show that it was unauthorized or fraudulent, or to create suspicion.

This applies to transfers by executors. Transferees of stock from an executor, with notice of his character, are charged with notice that there is a will, and of its contents, and of any statute restricting the power of an executor to dispose of property of the estate. Where there are no such restrictions an executor has power to sell stock belonging to the estate, and a bona fide purchaser from him acquires a good title notwithstanding a breach of trust.

Whether a transferee of shares from a trustee acquires title as against the equitable rights of the *cestui que trust* depends upon the circumstances. If the trustee appears on the books of the corporation as the absolute owner of the shares, and the transferee has no notice, actual or constructive, that he holds the title in trust, he certainly acquires a good title.¹²⁰ The fact that the transfer is not registered on the books of the corporation as required by a charter or statutory provision is immaterial, for registration is not necessary to pass the title as between the transferrer and transferee.¹²¹ The rule is different where the transferee has actual or constructive notice that the shares are held in trust. In such a case, as a general rule, he takes subject to the trust and in sub-

¹¹⁹ Pratt v. Higginson, 230 Mass. 256, 119 N. E. 661, 1 A. L. R. 714; Heney v. Sutro & Co., 28 Cal. App. 698, 153 Pac. 972. See note 28 Yale Law Journal 175, Conversion by innocent agents.

¹²⁰ Dodds v. Hills, 2 Hem. & M. 424; Winter v. Montgomery Gas-Light Co., 89 Ala. 544, 7 So. 773; Salisbury Mills v. Townsend, 109

Mass. 115; Loring v. Salisbury Mills, 125 Mass. 138; Anderson v. Waco State Bank, 92 Tex. 506, 49 S. W. 1030, 71 Am. St. Rep. 867; Dueber Watch Case Mfg. Co. v. Daugherty, 62 Ohio St. 589, 57 N. E. 455. See ante, § 149, note 76.

¹²¹ Dodds v. Hills, 2 Hem. & M. 424; Winter v. Montgomery Gas-Light Co., 89 Ala. 544, 7 So. 773.

ordination to the equitable rights of the *cestui que trust*.¹²² "Notice of the existence of a trust is by all the authorities held to impose the duty of inquiry as to its character and limitations. And whatever is sufficient to put a person of ordinary prudence upon inquiry is constructive notice of everything to which that inquiry might have led."¹²³

If the books of the corporation, when the shares of stock are transferable only on the books, or the certificate of stock, show that the shares are held in trust, as where they are in the name of a person "as trustee," the recitals therein are constructive notice to any one who purchases the shares, and one who purchases from the trustee, or lends him money, and takes a pledge of the shares as security, does so at his peril, unless the transaction is such as is ordinarily within the authority of a person holding property as trustee.¹²⁴ There can be no doubt that this rule applies where a person holding a certificate of stock "as trustee" pledges, or transfers the same as security for or in payment of his own debt, for this is of itself sufficient to put the person taking the certificate upon inquiry.¹²⁵ If a trustee has authority to sell and transfer shares, the title of a *bona fide* purchaser is not affected by the fact that, unknown to him, the sale is made in violation of the trust.¹²⁶

Liability of corporation.—What has been said above applies to the corporation itself where it is sought to hold it liable for permitting a transfer of stock by a trustee in violation of the trust. When the books of a corporation show that shares of stock are held by a person "as trustee," the officers of the corporation

¹²² *Shaw v. Spencer*, 100 Mass. 382, 97 Am. Dec. 107, 1 Am. Rep. 115; *Winter v. Montgomery Gas-Light Co.*, 89 Ala. 544, 7 So. 773.

¹²³ *Foster, J.*, in *Shaw v. Spencer*, 100 Mass. 382, 97 Am. Dec. 107, 1 Am. Rep. 115.

¹²⁴ *Shaw v. Spencer*, 100 Mass. 382, 97 Am. Dec. 107, 1 Am. Rep. 115; *Stewart v. Firemen's Ins. Co. of Baltimore*, 53 Md. 564; *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648, 20 Am. St. Rep. 467; *Geyser-Marion Gold-Min. Co. v. Stark*, 106 Fed. 558, 53 L. R. A. 684; *Clemens v. Heckscher*, 185 Pa. St. 476, 40 Atl. 80. But see *Northwestern Portland Cement Co. v. Atlantic Portland Cement Co. of New York*, 174 Cal. 308, 163 Pac. 47;

Young v. New Pedrara Onyx Co., 48 Cal. App. 1, 192 Pac. 55 (mere addition of word "trustee" not necessarily notice to any one dealing with such holder that he has not power to sell or pledge stock).

¹²⁵ *Shaw v. Spencer*, 100 Mass. 382, 97 Am. Dec. 107, 1 Am. Rep. 115; *Clemens v. Heckscher*, 185 Pa. St. 476, 40 Atl. 80; *First Nat. Bank of Paterson v. National Broadway Bank*, 22 N. Y. App. Div. 24, 47 N. Y. Supp. 880, modified 156 N. Y. 459, 51 N. E. 398, 42 L. R. A. 139.

¹²⁶ *Lowry v. Commercial & Farmers' Bank of Baltimore*, Taney 310, Fed. Cas. No. 8581; *Albert v. Savings Bank of Baltimore*, 1 Md. Ch. 407; *Brewster v. Sime*, 42 Cal. 139.

are charged with notice that he does not hold the shares in his own right.¹²⁷ And it will be liable if it permits the trustee to transfer the stock under circumstances which render the transfer inconsistent with the trust. A corporation is liable for an unauthorized transfer of stock which stands on its books in the name of a person as trustee, for a trustee is not presumed to have the right to sell or transfer, and the corporation is chargeable with notice that, in doing so without producing his authority, he is probably violating his trust.¹²⁸

Transfers by executors.—Persons who purchase shares of stock from an executor, with actual or constructive notice of the character in which he holds the title, and the corporation in allowing and registering a transfer, are chargeable with notice of the contents of the will under which he acquired title, and any restrictions therein.¹²⁹ A distinction is drawn between cases where the transferee is a legatee named in the will and cases where the executor sells and transfers the stock to a purchaser.¹³⁰ A corporation is charged with notice of the contents of the will and the limits on the executor's authority where it transfers stock upon the execu-

¹²⁷ *Brewster v. Hartley*, 37 Cal. 15, 99 Am. Dec. 237. See *Scott, Participation in a Breach of Trust*, 34 Harvard Law Rev. 454, 465: "The effect of this doctrine is to put upon the corporation responsibility for preventing breaches of trust. But it seems absurd to compel the transfer agent of a corporation to determine the different questions which may arise as to the powers of a trustee." See also, 3 Massachusetts Law Quarterly 70, 284.

¹²⁸ *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648, 20 Am. St. Rep. 467; *Loring v. Salisbury Mills*, 125 Mass. 138; *Geyser-Marion Gold Min. Co. v. Stark*, 106 Fed. 558, 53 L. R. A. 684; *Cox v. First Nat. Bank of Wilson*, 119 N. C. 302, 26 S. E. 22; *Wooten v. Wilmington & W. R. Co.*, 128 N. C. 119, 38 S. E. 298, 56 L. R. A. 615.

Where shares of stock stand on the books of a corporation in the name of a decedent, and a transfer is made by his executors to another person as trustee, the corporation is chargeable with notice of the will and is required, before permitting a transfer by a trustee, to inform itself of the

terms of the will, and of the trust upon which the executors were thereby authorized to transfer the stock to the trustee; and it will be liable if it permits the latter to transfer the stock under circumstances inconsistent with the trust. *Stewart v. Firemen's Ins. Co. of Baltimore*, 53 Md. 564, 565; *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648, 20 Am. St. Rep. 467.

¹²⁹ *Lowry v. Commercial & Farmers' Bank of Baltimore*, Taney 310, Fed. Cas. No. 8581; *Albert v. Savings Bank of Baltimore*, 2 Md. 159, 1 Md. Ch. 407; *Stewart v. Firemen's Ins. Co. of Baltimore*, 53 Md. 564; *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648, 20 Am. St. Rep. 467; *Caulkins v. Gas-Light Co.*, 85 Tenn. 683, 4 S. W. 287, 4 Am. St. Rep. 786.

¹³⁰ *Wooten v. Wilmington & W. R. Co.*, 128 N. C. 119, 38 S. E. 298, 56 L. R. A. 615; *Baker v. Atlantic Coast Line R. Co.*, 173 N. C. 365, 92 S. E. 170, L. R. A. 1917 E 266. If the corporation transfers the stock to a life tenant absolutely it may become liable to the remainderman. 14 C. J. 775; *Cook, Corporations*, secs. 329, 330, 398.

tor's request to legatees who have only a limited interest. The corporation is bound to exercise reasonable care to protect the title of an equitable owner against an unauthorized transfer. They are also chargeable with notice of any restrictions upon his power to dispose of the shares imposed by the general law.^{130a} But where there are no restrictions in the will upon the power of the executor to dispose of the stock, and none are imposed by statute, his power to sell the stock for the purpose of converting the same into money to pay debts or distribute the same to legatees is absolute, the conversion of the testator's personal estate into money being within the ordinary line of an executor's duty, and persons who purchase from him in good faith acquire a good title, and the corporation, in allowing a transfer, incurs no liability, notwithstanding breach of trust or conversion on his part.¹³¹ Persons who purchase or take a pledge of stock from an executor with notice that he is disposing of the stock for his own purposes are not protected.¹³²

§ 153. Effect of transfers in general.—When a bona fide and valid transfer of shares is made to a person capable of assuming the obligations of a stockholder, the effect is to substitute the transferee as a stockholder in the place of the transferrer; and therefore, in the absence of express provision or agreement to the contrary—

- (1) The transferrer is liable for calls made prior to the transfer, but not for future calls; and the transferee is not liable for calls made prior to the transfer, but is liable for future calls, unless the stock was issued as full-paid, or the certificate is in such form, and he is a bona fide purchaser. This is changed in some states by statute.
- (2) In most jurisdictions, but not in all, the transferrer is no longer subject to a statutory liability to creditors of the corporation, but the transferee is liable.
- (3) The transferee is entitled to a new certificate of stock.

^{130a} *Weyer v. Second Nat. Bank of Franklin*, 57 Ind. 198.

¹³¹ *Lowry v. Commercial & Farmers' Bank of Baltimore*, Taney 310, Fed. Cas. No. 8581; *Weyer v. Second Nat. Bank of Franklin*, 57 Ind. 198; *Hutchins v. State Bank*, 12 Metc. (Mass.) 421; *Wooten v. Wilmington & W. R. Co.*, supra, note 130. Exec-

utors and administrators, unlike trustees, may have implied power to sell stock and other personal property without order of court in order to pay debts.

¹³² *Shaw v. Spencer*, 100 Mass. 382, 97 Am. Dec. 107, 1 Am. Rep. 115; *Field v. Schieffelin*, 7 Johns. Ch. (N. Y.) 150, 11 Am. Dec. 441.

- (4) The transferrer is entitled to dividends declared prior to the transfer, while the transferee is entitled to dividends declared after the transfer.

Except as outlined above, and as will be more fully shown in the following sections, the general rule is that a valid transfer of shares, when completed, substitutes the transferee for the transferrer as a stockholder in the corporation with respect both to rights and to liabilities. The transferrer ceases to be a stockholder, and neither has any further rights, nor is subject to any further liabilities, as such. The transferee comes in and takes his place. "After assignment the assignees hold the shares on the same conditions, and are subject to the same rules and orders as the original subscribers, and are to all intents and purposes substituted in the places of the original subscribers."¹³³

Liability for assessments or calls.—Since a valid and complete transfer of shares operates as a novation of the contract of membership, and substitutes the transferee for the transferrer as a stockholder, it is well settled in most jurisdictions in the absence of express provision to the contrary, that a transferee of shares not issued as full-paid is liable on implied contract for all future calls thereon, both to the corporation and to its creditors, but is not liable on calls made prior to the transfer, although not payable until afterwards; and the transferrer is liable for calls made prior to the transfer, but not for calls made afterwards.¹³⁴

¹³³ Lord Kenyon, C. J., in *Huddersfield Canal Co. v. Buckley*, 7 Term R. 36. And see *Bend v. Susquehanna Bridge & Bank Co.*, 6 Har. & J. (Md.) 128, 14 Am. Dec. 261; *West Nashville Planing-Mill Co. v. Nashville Sav. Bank*, 86 Tenn. 252, 6 S. W. 340, 6 Am. St. Rep. 335; *Visalia & T. R. Co. v. Hyde*, 110 Cal. 632, 43 Pac. 10, 52 Am. St. Rep. 136.

¹³⁴ *Geary St., P. & O. R. Co. v. Bradbury Estate Co.*, 179 Cal. 46, 175 Pac. 457; *Webster v. Upton*, 91 U. S. 65, 23 L. Ed. 384; *Visalia & T. R. Co. v. Hyde*, 110 Cal. 632, 43 Pac. 10, 52 Am. St. Rep. 136; *Allen v. Montgomery R. Co.*, 11 Ala. 437; *Schenectady & S. Plank Road Co. v. Thatcher*, 11 N. Y. 102; *Brant v. Ehlen*, 59 Md. 1; *West Nashville Planing-Mill Co. v. Nashville Sav. Bank*, 86 Tenn. 252, 6 S. W. 340, 6 Am. St. Rep. 335; *In re Bell's Ap-*

peal, 115 Pa. St. 88, 8 Atl. 177, 2 Am. St. Rep. 532, distinguishing and limiting the earlier cases in Pennsylvania.

There is an implied promise or obligation on the part of the transferee to indemnify his transferor the registered owner for calls made while the transferee was the real owner of the stock, though prior to transfer on the books. 39 *Harvard Law Rev.* 123.

The rights and liabilities of a subscriber for stock may be transferred, and if the corporation accepts the transferee there is a complete novation which will operate to release the original subscriber, unless fraud on creditors is shown, at least as to subsequent creditors. *Butts v. King*, 101 Conn. 291, 125 Atl. 654, noted in 19 *Illinois Law Rev.* 368. See *Smith v. General Motors Corp.*, 289 Fed. 205.

Statutory liability to creditors of the corporation.—What has been said above applies generally to the liability imposed by statute upon stockholders to or for the benefit of creditors of the corporation, but not necessarily so. These statutes vary somewhat in the different states, and even when they are similar there is some conflict in construing them. The subject will be considered to better advantage in a subsequent chapter.¹³⁵

Right to a certificate.—When a valid transfer of shares is made, the transferee is entitled to a certificate of stock on the production of proper evidence of the assignment to the officers of the corporation, and making a demand therefor.¹³⁶

Right to dividends.—The effect of a transfer of shares upon the right to receive dividends thereon will be considered in another chapter. The matter may be regulated by agreement between the parties. In the absence of such an agreement, the transferrer is entitled to all dividends declared prior to the transfer, although not payable until afterwards, for the right thereto has become vested; and the transferee is entitled to all dividends declared after the transfer, whether the profits out of which they were declared were earned before or afterwards.¹³⁷

§ 154. Lien of corporation on shares.—A corporation, at common law, has no lien on the shares of its capital stock for debts due from its stockholders; but such a lien may be acquired by it in the following ways, and subject to the following limitations:

- (1) It may be acquired by virtue of an express provision therefor in the charter of the corporation or a general law, or by a provision in the articles of association, if such provision is not inconsistent with the charter or general law. And in such a case it may be enforced, not only as against the stockholders and purchasers with notice, but also as against bona fide purchasers without actual notice.

¹³⁵ See post, § 222f.

¹³⁶ *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90, 19 Am. Dec. 306. See post, § 155.

The sale and transfer of stock by an infant being voidable only, the corporation has no right to refuse a

transfer. It may be compelled by the purchaser to transfer the stock on its books to him and issue him a certificate. *Casey v. Kastel*, 237 N. Y. 305, 142 N. E. 671.

¹³⁷ Post, § 160.

- (2) It may be acquired by virtue of a by-law expressly authorized by the charter or general law, or by a by-law not expressly so authorized, if it is not inconsistent with the charter or general law; but in the latter case the by-law is not valid as against bona fide purchasers without notice.
- (3) It may be acquired by virtue of a special or implied contract between the corporation and a stockholder, if such a contract is not prohibited by the charter or general law; but in such a case the lien cannot be enforced as against bona fide purchasers without notice.

It is well settled that, in the absence of an express charter or statutory provision, or a valid by-law, or an agreement, a corporation has no lien upon the shares of its stock for debts which may be due to it from the stockholders; and a *bona fide* transfer of shares is therefore valid as against the corporation, where there is no provision or agreement for a lien, notwithstanding any claim it may have against the transferrer, whether the claim is for a balance due on the stock, or for a loan or other indebtedness.¹³⁸ There are several ways, however, in which a corporation may acquire a lien on its shares for debts due from the stockholders.

Such a lien may clearly be given by an express provision in its charter or in a general law. In such a case, all persons who purchase shares in the corporation are chargeable with notice of the provision, and the corporation has a lien, not only as against the stockholders and transferees with notice, but also as against *bona fide* purchasers or pledgees without actual notice, unless it waives the lien, or is estopped by its conduct from asserting the same.¹³⁹ The corporation need not allow a transfer of the stock to the transferee on the books until the debt is paid and may be able to foreclose

¹³⁸ First Nat. Bank of South Bend v. Lanier, 11 Wall. (U. S.) 369, 20 L. Ed. 172; Farmers' & Merchants' Bank of Lineville v. Wasson, 48 Iowa 336, 30 Am. Rep. 398; Gemmell v. Davis, 75 Md. 546, 23 Atl. 1032, 32 Am. St. Rep. 412; Sargent v. Franklin Ins. Co., 8 Pick. (Mass.) 90, 19 Am. Dec. 306; Bank of Holly Springs v. Pinson, 58 Miss. 421, 38 Am. Rep. 330; Bank of Atchison County v. Durfee, 118 Mo. 431, 24 S. W. 133, 40 Am. St. Rep. 396; Bank of Attica v. Manufacturers' & Traders' Bank, 20 N. Y. 501; Driscoll v. West Bradley & Cary Mfg. Co., 59

N. Y. 96; Boyd v. Redd, 120 N. C. 335, 27 S. E. 35, 58 Am. St. Rep. 792; Damron v. Denny, 149 Ga. 280, 99 S. E. 851; Iowa-Missouri Grain Co. v. Powers, 198 Iowa 208, 191 N. W. 363, 196 N. W. 979; Kingsbury & Co. v. Riverton-Wyoming Refining Co., 68 Colo. 581, 192 Pac. 503.

¹³⁹ Union Bank of Georgetown v. Laird, 2 Wheat. (U. S.) 390, 4 L. Ed. 269; Brent v. Bank of Washington, 10 Pet. (U. S.) 596, 9 L. Ed. 547; Bishop v. Globe Co., 135 Mass. 132; Dorr v. Life Ins. Clearing Co., 71 Minn. 38, 73 N. W. 635, 70 Am. St. Rep. 309.

the lien by sale.¹⁴⁰ The lien generally covers all debts due from a registered stockholder, including any unpaid balance of the subscription price, whether due or not due. The lien may cover debts incurred by the one registered as stockholder even after transfer of the certificate, before notice to the corporation.

The fact that a corporation has a lien on shares for a debt due from the stockholder, even when it gives the corporation a right to refuse to transfer the shares on its books until the indebtedness is satisfied, does not prevent the stockholder from assigning the shares subject to the lien, so as to transfer his equitable interest.¹⁴¹ In *Craig v. Hesperia Land & Water Co.*,¹⁴² it was held where a corporation has a lien upon the shares of stock for the payment of delinquent assessments thereon, that it had no right to prevent a transfer of the certificates, as the shares would remain subject to the lien, and the new owner could take subject thereto.

It is now well settled, at least in most jurisdictions, that a *bona fide* purchaser of a certificate of stock takes the same free from any secret liens in favor of the corporation created by contract or by-laws. Although the certificate is not negotiable, the corporation, by issuing it and making it transferable by delivery, is estopped to set up a secret lien as against a *bona fide* purchaser.¹⁴³ If it were necessary for a purchaser of shares to trace his shares back to the original issue by the numbers of the different certificates in the stock book in which the original issue and all subsequent transfers are entered, and identify the shares upon which any assessment had been made or ascertain whether any holder had been indebted to the corporation after the manner that a purchaser must search the title to real estate, the transfer of stock would indeed be made risky and burdensome.¹⁴⁴

¹⁴⁰ Cook, Corporations, secs. 425, 523; Fletcher, Corporations, p. 3600; Dorr v. Life Ins. Clearing Co., 71 Minn. 38, 73 N. W. 635, 70 Am. St. Rep. 309.

¹⁴¹ Cecil Nat. Bank v. Watson town Bank, 105 U. S. 217, 26 L. Ed. 1039; Herdegen v. Cotzhausen, 70 Wis. 589, 36 N. W. 385.

¹⁴² 113 Cal. 7, 45 Pac. 10, 35 L. R. A. 306, 54 Am. St. Rep. 316. See Ramage v. Gould, 176 Cal. 746, 169 Pac. 670, attachment lien does not interfere with the right to transfer title and demand new certificate.

¹⁴³ First Nat. Bank of South Bend

v. Lanier, 11 Wall. (U. S.) 369, 377, 20 L. Ed. 172; Anglo-Californian Bank v. Grangers' Bank, 63 Cal. 359; Bank of Atchison County v. Durfee, 118 Mo. 431, 24 S. W. 133, 40 Am. St. Rep. 396. And see ante § 143; Iowa-Missouri Grain Co. v. Powers, 198 Iowa 208, 191 N. W. 363, 196 N. W. 979. Compare, however, *Craig v. Hesperia Land & Water Co.*, 113 Cal. 7, 45 Pac. 10, 35 L. R. A. 306, 54 Am. St. Rep. 316.

¹⁴⁴ But see *Craig v. Hesperia Land & Water Co.*, 113 Cal. 7, 45 Pac. 10, 35 L. R. A. 306, 54 Am. St. Rep. 316.

§ 155. Refusal of corporation to recognize and register transfers.—If a corporation wrongfully refuses to allow a transfer on its books to an assignee of a certificate of stock, and issue a new certificate, he has several remedies:

- (1) He may maintain an action against the corporation for damages.
- (2) He may maintain a suit in equity to compel the corporation to register the transfer, and issue a new certificate.
- (3) There is a conflict of authority whether mandamus will lie.

A corporation cannot be required to register a transfer of stock, and issue a new certificate, without the production and surrender of the original certificate, unless it is protected against possible liability to bona fide purchasers thereof.

If a corporation wrongfully refuses to recognize a valid transfer of stock and to permit a transfer on its books, the transferee has a choice of remedies. The duty to permit a transfer raises an implied promise on the part of the corporation, for a breach of which the transferee may maintain an action of *assumpsit* to recover the damages sustained by him by reason of the refusal.¹⁴⁵ Or he may treat the wrongful refusal to allow a transfer as a conversion of the shares, and recover the value of the stock in an action of trover for the conversion.¹⁴⁶ An action for damages does not always afford an adequate remedy for refusal of a corporation to

The Uniform Stock Transfer Act provides: "Section 15. There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation and there shall be no restriction upon the transfer of shares so represented by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate." Uniform State Laws, Annotated, Terry, p. 350.

Third Nat. Bank v. Buffalo German Ins. Co., 193 U. S. 581, 48 L. Ed. 801, 24 Sup. Ct. 524. A provision in the charter and by-laws, and a condition in a certificate of stock of a national bank, forbidding the transfer of the stock where the stockholder is indebted to the bank is void as repugnant to the National Banking Act and in conflict with the policy of the act to make the stock freely transferable, and creates no lien

which the bank can enforce by refusing to transfer the stock.

¹⁴⁵ Rex v. Bank of England, 2 Doug. 525; Shipley v. Mechanics' Bank, 10 Johns. (N. Y.) 484; Commercial Bank of Buffalo v. Kortright, 22 Wend. (N. Y.) 348, 34 Am. Dec. 317; Sargent v. Franklin Ins. Co., 8 Pick. (Mass.) 90, 19 Am. Dec. 306; Scripture v. Francetown Soapstone Co., 50 N. H. 571; Pinkerton v. Manchester & L. R. R., 42 N. H. 424. See Travis v. Knox Terpezone Co., 215 N. Y. 259, 109 N. E. 250, L. R. A. 1916 A 542, Ann. Cas. 1917 A 387.

¹⁴⁶ Cincinnati Finance Co. v. Booth, 111 Ohio St. 361, 145 N. E. 543; Plymouth Bank v. Bank of Norfolk, 10 Pick. (Mass.) 454; Bond v. Mount Hope Iron Co., 99 Mass. 505, 97 Am. Dec. 49; Craig v. Hesperia Land & Water Co., 113 Cal. 7, 45 Pac. 10, 35 L. R. A. 306, 54 Am. St. Rep. 316; Nicollet Nat. Bank v. City Bank, 38 Minn. 85, 35 N. W. 577, 8 Am. St.

recognize a person as a stockholder, and it is well settled, therefore, that if a corporation wrongfully refuses to recognize and register a valid transfer of stock, and issue a new certificate to the transferee, he may maintain a bill in equity to compel it to do so.¹⁴⁷

In some jurisdictions it has been held that *mandamus* will lie to compel a corporation to register a transfer of stock, and issue a new certificate to the transferee.¹⁴⁸ But the weight of authority is to the contrary. The general rule is that *mandamus* will not lie when there is an adequate remedy by ordinary process of law; and since a transferee of a certificate of stock has an adequate remedy at law by an action to recover damages, or in equity by a suit to compel the corporation to register his transfer, and issue him a proper certificate, in case the corporation wrongfully refuses to recognize the transfer, many courts have held that *mandamus* will not lie.¹⁴⁹

Of course, a corporation is not liable for refusal to permit a transfer on its books to the assignee of a certificate of stock, unless the circumstances are such as to entitle the latter to a transfer on the books, and to render the refusal wrongful.¹⁵⁰ Thus, the corporation is not liable if it has a lien upon the shares as against the transferee;¹⁵¹ or if it has notice of a prior valid transfer to

Rep. 643; *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 38 Am. Rep. 330; *Jones v. Osage Oil & Refining Co.*, 280 Fed. 696. See 38 Harvard Law Rev. 829: "Since the judgment debtor in action for conversion becomes owner of the converted property, the corporation must, in effect, purchase its own stock. Unless the corporation has a surplus, this is improper as an impairment of capital stock. . . . Where the judgment would result in such impairment, the assignees' remedy should be confined to specific redress."

A corporation which transfers stock sold by an infant stockholder and cancels the infant's stock certificate is not guilty of conversion when the infant later disaffirms the transfer. The transfer being voidable merely, the corporation had no right to refuse a transfer. *Casey v. Kastel*, 237 N. Y. 305, 142 N. E. 671, 31 A. L. R. 995.

¹⁴⁷ *Cushman v. Thayer Mfg. Jewelry Co.*, 76 N. Y. 365, 32 Am. Rep. 315; *Rice v. Rockefeller*, 134 N. Y.

174, 31 N. E. 907, 17 L. R. A. 237, 30 Am. St. Rep. 658; *Cecil Nat. Bank v. Watson town Bank*, 105 U. S. 217, 26 L. Ed. 1039; *Jones v. Osage Oil & Refining Co.*, 280 Fed. 696; *Lask v. Bedell, Inc.*, 91 N. J. Eq. 341, 109 Atl. 849, 111 Atl. 926.

¹⁴⁸ *People v. Crockett*, 9 Cal. 112; *State v. McIver*, 2 Rich. (S. C.) 25; *In re Klaus*, 67 Wis. 401, 29 N. W. 582; *Citizens Nat. Bank v. State ex rel. Kellogg*, 179 Ind. 621, 101 N. E. 660, 45 L. R. A. (N. S.) 1075, 1076n.

¹⁴⁹ *Rex v. Bank of England*, 2 Doug. 526; *Kimball v. Union Water Co.*, 44 Cal. 173, 13 Am. Rep. 157; *American Asylum v. Phoenix Bank*, 4 Conn. 172, 10 Am. Dec. 112; *Shipley v. Mechanics' Bank*, 10 Johns. (N. Y.) 484; *Freon v. Carriage Co.*, 42 Ohio St. 30, 51 Am. Rep. 794; *Fletcher, Corporations*, sec. 3818.

¹⁵⁰ *Bridgeport Bank v. New York & N. H. R. Co.*, 30 Conn. 231.

¹⁵¹ *Brent v. Bank of Washington*, 10 Pet. (U. S.) 596, 9 L. Ed. 547; *Reese v. Bank of Commerce*, 14 Md. 271, 74 Am. Dec. 536; *Morgan v.*

another person, which is good as against the person demanding registration.¹⁵² Since a corporation will be liable to the owner of stock if it allows a transfer on its books under a forged or unauthorized assignment and power of attorney, or otherwise in violation of his rights, it may require a person demanding a transfer on its books to produce evidence of his identity and of his right to the transfer, and therefore its refusal to register a transfer and issue a new certificate without such evidence is not wrongful.¹⁵³

When may corporations refuse to register on their books transfers of stock? It has been held that the officers of a corporation have no right to withhold their assent to a transfer because in their opinion the motives or purposes of the parties are improper, as on the ground that the object of the transfer is to obtain control of the corporation, or affect the voting at corporate meetings;¹⁵⁴ or because the transferee is a business rival of the corporation, and may make use of his ownership of the shares in hostility to its interests.¹⁵⁵ It is otherwise, however, where the transfer is not made in good faith, but is merely colorable, and for the purpose of giving the transferee privileges of membership to which only *bona fide* and actual owners of shares are entitled.¹⁵⁶

Production and surrender of old certificate.—As was shown in another section, if a corporation issues a certificate of stock, the certificate, so long as it is outstanding, constitutes a continuing affirmation that the person named therein is the owner of the

Bank of North America, 8 Serg. & R. (Pa.) 73, 11 Am. Dec. 575; Se-wall v. Lancaster Bank, 17 Serg. & R. (Pa.) 285; Stafford v. Produce Exch. Banking Co., 61 Ohio St. 160, 55 N. E. 162, 76 Am. St. Rep. 371.

¹⁵² See Dickinson v. Central Nat. Bank, 129 Mass. 279, 37 Am. Rep. 351. In O'Neil v. Wolcott Min. Co., 174 Fed. 527, 27 L. R. A. (N. S.) 200, it is held that where an adverse claimant fails to establish his opposing claim or commence any action to prevent the transfer within a reasonable time, it is the duty of the corporation to record the transfer demanded by the first claimant. Evidence of some adverse title, interest or lien that at least raises a substantial doubt of the right of the demandant to a transfer is indispensable to a refusal to make it. A mere claim is not sufficient. See 58 Univ. Pa.

Law Rev. 500; Fletcher, Corporations, sec. 3824.

¹⁵³ Western U. Tel. Co. v. Davenport, 97 U. S. 369, 24 L. Ed. 1047. See also, Chew v. Bank of Baltimore, 14 Md. 299.

¹⁵⁴ Moffatt v. Farquhar, 7 Ch. Div. 591; In re Klaus, 67 Wis. 401, 29 N. W. 582; Rice v. Rockefeller, 134 N. Y. 174, 31 N. E. 907, 17 L. R. A. 237, 30 Am. St. Rep. 658. Cp. Senn v. Union Premium & Mercantile Co., 115 Mo. App. 685, 92 S. W. 507; Gould v. Head, 41 Fed. 240.

¹⁵⁵ Rice v. Rockefeller, 134 N. Y. 174, 31 N. E. 907, 17 L. R. A. 237, 30 Am. St. Rep. 658. See Farmers' Loan & Trust Co. v. Chicago, P. & S. R. Co., 163 U. S. 31, 41 L. Ed. 60, 16 Sup. Ct. 917.

¹⁵⁶ Baker's Appeal, 108 Pa. St. 510, 1 Atl. 78, 56 Am. Rep. 231; Reg. v. Liverpool, M. & N. Ry. Co., 21

number of shares therein specified, and has the right to transfer the same, and it will be estopped to deny such affirmation as against *bona fide* purchasers of the certificate.¹⁵⁷ It follows that, if a corporation transfers shares on its books and issues a new certificate therefor while the original certificate is outstanding, it runs the risk of incurring liability on both certificates in the hands of *bona fide* purchasers. It is well settled, therefore, that a corporation is not bound, and cannot be required, to register a transfer of stock, and issue a new certificate, unless the original certificate is produced and surrendered, or is clearly shown to have been destroyed or lost, or unless the decree adequately protects it against possible liability by reason of the outstanding certificate.¹⁵⁸

It follows from this doctrine that a court cannot properly compel a corporation to register a transfer of stock and issue a new certificate therefor while the original certificate, which was lawfully issued by it, is outstanding, so that it may pass, or may have passed, into the hands of a *bona fide* purchaser. The decree should protect the corporation by requiring the registration of the transfer and issuance of a new certificate only upon surrender of the outstanding original certificate, which surrender it may compel, if it has jurisdiction of the holder.¹⁵⁹

L. J. Q. B. 284; Gould v. Head, 41 Fed. 240.

¹⁵⁷ Ante, § 138 et seq.

¹⁵⁸ Holbrook v. New Jersey Zinc Co., 57 N. Y. 616; Bean v. American Loan & Trust Co., 122 N. Y. 622, 26 N. E. 11; Joslyn v. St. Paul Distilling Co., 44 Minn. 183, 46 N. W. 337; Supply Ditch Co. v. Elliott, 10 Colo.

327, 15 Pac. 691, 3 Am. St. Rep. 586; Ohman v. Lee, 149 Minn. 451, 184 N. W. 41.

¹⁵⁹ Parkhurst v. Almy, 222 Mass. 27, 109 N. E. 733; Harris v. Mid-Continent Life Ins. Co., 75 Okla. 105, 182 Pac. 85; 33 Harvard Law Rev. 109.

CHAPTER XIV.

RIGHTS OF STOCKHOLDERS.

I. DIVIDENDS.

§ 156. Distribution of profits.—A dividend is a distribution of the profits of a corporation ordered by the directors to be made among its stockholders or members in proportion to their respective shares or interest in the corporation.

What is the end and purpose of a business corporation? In general it is to combine those who take stock in an association having corporate capacity and privileges, and to transact business of a specified sort for the benefit of the stockholders. They are to be entitled to the profits of the business and to have such profits seasonably divided among them in proportion to the amount of stock held by each. It is not the purpose to go on year after year adding profits to capital, accumulating a surplus indefinitely. As the Michigan court said in the case of *Dodge v. Ford Motor Co.*¹: “A business corporation is organized and carried on primarily for the profit of the stockholders. . . . The discretion of the directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders, in order to devote them to other purposes.” If it becomes the avowed purpose of the directors to sacrifice the interests of the shareholders, it is the duty of the courts to interfere to restrain such abuse of their discretion. In the ordinary corporation formed for business or commercial purposes profits must be distributed evenly among the stockholders in proportion to the amount of stock held by each.²

¹ 1204 Mich. 459, 170 N. W. 668, 684, 3 A. L. R. 413.

² But in the so-called “co-operative associations” organized by the producers of fruit, cotton, tobacco and other commodities, the distribution of profits is usually in the form of trade

dividends on the basis of patronage rather than according to the amount of stock held, and nonmember patrons are often allowed to participate in the distribution of surplus on the same basis with member patrons. Under the pooling system, business

A declaration of a dividend is sometimes spoken of as a severance or setting apart from its profits of a fund to be distributed among the stockholders. But in truth the declaration merely creates a debt. All that can be meant by "severance" or "setting apart" is that the declaration creates an immediate right in the stockholder as a creditor. After the dividend is declared the right to this share of the profits becomes individualized and fixed in the stockholder at the time of the declaration, and does not pass by a transfer of the stock unless expressly or impliedly so agreed.³

§ 157. **Stockholders' right to share in profits.**—Until a dividend has been declared, the stockholders of a corporation have only a right to the exercise of honest discretion by the directors as to the distribution of surplus profits out of which a dividend might properly be declared; but as soon as the directors have properly declared a cash dividend, each stockholder becomes a creditor and may maintain an action against the corporation to recover the amount due him.

It follows that, after a dividend has been lawfully declared by the directors, and the right of the stockholders has vested, the action of the directors cannot be revoked.

Nor are the rights of stockholders as creditors of the corporation affected by its subsequent insolvency.

It is discretionary with the directors of a corporation whether they will declare a dividend, even when there are surplus profits, and, as a general rule, the courts will not control them in the exercise of this discretion, unless they act in bad faith or are guilty of palpable abuse of discretion.

Most prosperous corporations make a dividend at least annually and more often quarterly. Corporations steadily earning profits are expected to divide a portion of them by the investor, just as the farmer expects to reap his harvest. The stockholders bear the risks attendant upon the business; they are entitled to reap the profits if they can be distributed without injury to the business.

may be conducted at cost, so that there will be no net earnings or profits coming to the association for distribution. *Mooney v. Farmers' Mercantile & Elevator Co.*, 138 Minn. 199, 164 N. W. 804. See *Ballantine, Co-operative Marketing Associations*, 8 Minnesota Law Rev. 1, 5, 23.

³ "The underlying idea of a cash dividend . . . is the distribu-

tion to shareholders, as the rewards of the corporate enterprise, of a portion of the profits or surplus assets of the corporation." *Green v. Bissell*, 79 Conn. 547, 65 Atl. 1056, 8 L. R. A. (N. S.) 1011, 118 Am. St. Rep. 156, 9 Ann. Cas. 287. Compare, *2 Cook, Corporations* (8th Ed.), sec. 541; *Eaton v. English & Mersick Co.*, 7 Fed. (2d) 54.

The only practical benefit that stockholders may ordinarily expect from their investment in a corporation must come from the distribution of profits in the form of cash or property. It is of no benefit in itself that the corporation conducts its business successfully and piles up a huge surplus. All this may in the end go to future creditors along with the original investment, and often does where a business is unwisely expanded. Therefore where profits are unreasonably and unfairly retained from distribution for many years, it may be so great an abuse of discretion that equity will intervene at the instance of the stockholder and order a distribution out of surplus, even though it cannot be said that the directors are guilty of fraud or dishonesty.

The stockholders of a corporation may have the equitable right to insist that the profits from the corporate business shall be divided among them, but they have no *legal* right to any share therein, nor is there any indebtedness to them on the part of the corporation, so as to entitle them to maintain an action against it, until a dividend has been made or declared; and it can make no difference that the amount of the profits and the condition of the corporation are such that the directors might or should declare a dividend, and would be compelled by a court of equity to do so.⁴ After a dividend has been set apart or declared, the rule is different. As soon as a dividend is lawfully and fully declared out of surplus profits, the corporation becomes indebted from that moment to each stockholder for the amount of his share, and he may recover the same in an action against the corporation.⁵ A Connecticut corporation declared dividends from time to time and ordered them to be placed to the credit of each stockholder on the books of the company, payable "at such time as may be directed by the board." Finally it was ordered that the dividends credited to each stockholder be carried to a surplus fund account. It was held by the

⁴ Boardman v. Lake Shore & M. S. Ry. Co., 84 N. Y. 157; Jackson's Adm'rs v. Newark Plank Road Co., 31 N. J. Law 277; Wheeler v. Northwestern Sleigh Co., 39 Fed. 347; Burroughs v. North Carolina R. Co., 67 N. C. 376, 12 Am. Rep. 611; Godley v. Crandall & Godley, 212 N. Y. 121, 105 N. E. 818, L. R. A. 1915 D 632; American Steel Foundries v. Lazear, 204 Fed. 204.

⁵ Ford v. Easthampton Rubber Thread Co., 158 Mass. 84, 32 N. E. 1036, 20 L. R. A. 65, 35 Am. St. Rep.

462; Beers v. Bridgeport Spring Co., 42 Conn. 17; Le Roy v. Globe Ins. Co., 2 Edw. Ch. (N. Y.) 657; King v. Paterson & H. River R. Co., 29 N. J. Law 82; Wheeler v. Northwestern Sleigh Co., 39 Fed. 347; Jackson's Adm'rs v. Newark Plank Road Co., 31 N. J. Law 277; Staats v. Biograph Co., 236 Fed. 454, L. R. A. 1917 B 728; New York Trust Co. v. Edwards, 257 U. S. 176, 42 Sup. Ct. 68, 66 L. Ed. 186; Plant v. Walsh, 280 Fed. 722.

court that the dividends so declared should be restored and paid as soon as possible without serious injury to the corporation.⁶

Since the right of the stockholders of a corporation to a dividend becomes vested as soon as the dividend has been fully declared by the directors, and the corporation becomes their debtor though the time of payment is deferred, it follows that neither the same board of directors nor their successors can afterwards reconsider their action and revoke the declaration without the stockholders' consent.⁷ But a mere vote of the directors to pay a dividend may be revoked, if it has not been made public, or communicated to the stockholders, and no fund has been set apart or appropriated for payment of the dividend, for until there has been a public announcement of the vote the action of the directors is not final.⁸

When the directors have merely declared a dividend, the corporation is a debtor to each stockholder for the amount due him, and the stockholders are in the same position as other creditors. There is no trust relation, but simply the relation of debtor and creditor, even though the corporation may have an account with each stockholder on its books, and may credit him with the amount of the dividend due him.⁹ But when the directors have not only declared a dividend, but have set apart and appropriated a fund for its payment, the fund so set apart and appropriated is thereby separated from the other assets of the corporation, and becomes a trust fund in its hands, so that the stockholders have a right to

⁶ *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Northwestern Marble & Tile Co. v. Carlsen*, 116 Minn. 438, 133 N. W. 1014 (dividend held payable within a reasonable time, although the resolution made it payable "at such time as the finances of the corporation would in the judgment of the board of directors warrant").

⁷ See *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *King v. Paterson & H. River R. Co.*, 29 N. J. Law 82; *Dock v. Schlichter Jute Cordage Co.*, 167 Pa. St. 370, 31 Atl. 656.

It has been held that a vote of a corporation declaring a stock dividend does not give a stockholder a vested interest in the stock, as in the case of the declaration of a cash dividend by the directors, so as to prevent a subsequent vote rescinding the

declaration. *Terry v. Eagle Lock Co.*, 47 Conn. 141; *Staats v. Biograph Co.*, 236 Fed. 454, L. R. A. 1917 B 728. See, however, *Dock v. Schlichter Jute Cordage Co.*, 167 Pa. St. 370, 31 Atl. 656; 15 Michigan Law Rev. 432.

⁸ *Ford v. Easthampton Rubber Thread Co.*, 158 Mass. 84, 32 N. E. 1036, 20 L. R. A. 65, 35 Am. St. Rep. 462. But compare *McLaran v. Crescent Planing Mill Co.*, 117 Mo. App. 40, 93 S. W. 819, criticising the Massachusetts decision on the ground that the resolution of the directors *per se* creates a debt without any announcement or publication.

⁹ *In re Severn & Wye & Severn Bridge Ry. Co.*, 74 Law T. (N. S.) 219; *Hunt v. O'Shea*, 69 N. H. 600, 45 Atl. 480.

insist that it shall be applied in payment of the dividend, to the exclusion of any other claim against the corporation.¹⁰

Effect of insolvency.—Since stockholders have no legal right to share in profits until a dividend has been declared, the right of creditors of an insolvent corporation to have its assets applied to the satisfaction of their claims, before any distribution among the stockholders, attaches not only to the capital of the corporation, but also to undivided profits out of which a dividend might have been declared if the corporation had not become insolvent.¹¹ But when a dividend has been fully and lawfully declared, the stockholders are in precisely the same position as other creditors. If the corporation becomes insolvent before the dividend is paid or set apart, they are entitled to share *pro rata* with other creditors, and, if it becomes insolvent after the dividend is paid, they cannot be made to refund for the benefit of creditors.¹² When dividends have not only been declared out of surplus profits, but the fund for their payment has been set apart, and distinguished from the general mass of the company's funds, the fund so set apart becomes a trust fund for the payment of the dividends, and the right of the stockholders to receive the same as against creditors of the corporation is not affected by the subsequent insolvency of the corporation.¹³

An arbitrary distinction is drawn by the cases between the status of a fund set apart for the payment of a declared dividend and a fund deposited for the payment of interest on bonds. In the case of stockholders, the deposit will constitute a trust in which the corporation will hold its claim against the depositary in trust for the stockholders. But the deposit by the debtor corporation for the bondholders presumably makes the depositary the agent of the debtor and no trust will be inferred.¹⁴ In a New

¹⁰ *Le Roy v. Globe Ins. Co.*, 2 Edw. Ch. (N. Y.) 657; *In re Interborough Consol. Corp.*, 267 Fed. 914, 919. See also, 288 Fed. 334, 32 A. L. R. 932.

¹¹ *Scott v. Eagle Fire Co.*, 7 Paige (N. Y.) 198; *Curry v. Woodward*, 44 Ala. 305.

¹² *Stringer's Case (In re Mercantile Trading Co.)*, L. R. 4 Ch. App. 475.

¹³ *Le Roy v. Globe Ins. Co.*, 2 Edw. Ch. (N. Y.) 657; *McLaran v. Crescent Planing Mill Co.*, 117 Mo. App.

40, 93 S. W. 819; *In re Interborough Consol. Corporation*, 267 Fed. 914, 919.

¹⁴ *Guidise v. Island Refining Corp.*, 291 Fed. 922; *In re Interborough Consol. Corp.*, 288 Fed. 334, 32 A. L. R. 932. But see *Steel Cities Chemical Co. v. Virginia-Carolina Chemical Co.*, 7 Fed. (2d) 280, noted in 35 Yale Law Journal 684; *Grinnell*, Status of funds deposited for payment of interest on bonds, 19 Illinois Law Rev. 634.

Jersey case,¹⁵ a corporation declared a dividend and deposited funds sufficient to pay it with a trust company. Notice to the stockholders of the time and place of payment was published. Before the day of payment the trust company failed. A stockholder sued the corporation for his dividend. It was held that the corporation was the debtor of the stockholder for the dividend declared. The trust company in which the funds were deposited was the agent of the debtor and not of the creditors, the stockholders, who had not consented to this method of payment. The loss accordingly fell on the corporation and the stockholders' claim against the corporation was not affected.

Compelling declaration of dividends.—The A. Corporation, organized for the business of mining and selling coal is carrying on a very profitable business and has a large surplus from which it might properly declare dividends. The directors refuse to do so, and against the protests of many stockholders insist on devoting the entire surplus to expansion and the purchase of additional coal land. This policy may result in the ruin of the company if a business depression occurs. Can the stockholders compel the declaration of a dividend? If the directors of a corporation abuse their discretion, and fraudulently or arbitrarily refuse to pay a dividend, when the condition of the corporation makes it their duty to do so, a court of equity will compel them to do so at the suit of a stockholder.¹⁶ In *Dodge v. Ford Motor Co.*,¹⁷ it appeared that the corporation had a surplus of \$112,000,000; that it had an income of \$60,000,000 a year profits; that its total liabilities including capital stock were not over \$20,000,000; that the corporation had cash on hand of \$54,000,000. It was held an abuse of discretion not to make a distribution in addition to \$1,200,000, and the court ordered an extra dividend of \$19,000,000. In a New Jersey case,¹⁸ where the directors and officers of a "close" corporation

¹⁵ King v. Paterson & H. R. R. Co., 29 N. J. Law 504.

¹⁶ Pratt v. Pratt, Read & Co., 33 Conn. 446; Beers v. Bridgeport Spring Co., 42 Conn. 17; Belfast & M. L. R. Co. v. City of Belfast, 77 Me. 445, 1 Atl. 362; Blanchard v. Prudential Ins. Co. of America, 78 N. J. Eq. 471, 481, 79 Atl. 533; Burk v. Ottawa Gas & Electric Co., 87 Kan. 6, 123 Pac. 857, Ann. Cas. 1913 D 772; Seitz v. Union Brass & Metal Mfg. Co., 152 Minn. 460, 189 N. W.

586, 27 A. L. R. 293; Stevens v. United States Steel Corp., 63 N. J. Eq. 373, 59 Atl. 905; Reynolds v. Diamond Mills Paper Co., 69 N. J. Eq. 299, 60 Atl. 941. Compulsory declaration of dividends, see Wormser, 3 Southern Law Quarterly 281.

¹⁷ 204 Mich. 459, 170 N. W. 668, 3 A. L. R. 413.

¹⁸ Reynolds v. Diamond Mills Paper Co., 69 N. J. Eq. 299, 60 Atl. 941.

were pursuing the policy of using profits for the expansion of the business and the undue increase of salaries, the court said: "They should bear in mind that the only sure benefit to the stockholders to be derived from the successful prosecution of the corporate business must come from the distribution of dividends in cash, and that the piling up of a surplus, which remains undistributed, may in the end go wholly to future creditors of the corporation."

But it is a well-settled principle that whether or not dividends shall be paid, and the amount of the dividend at any time, is primarily to be determined by the directors, and there must be bad faith or a clear abuse of discretion on their part to justify a court of equity in interfering.¹⁹ The mere fact that a corporation has surplus profits out of which a dividend might lawfully be declared is not of itself sufficient ground for a court of equity to compel the directors to make a dividend, for they have a right to use surplus profits to extend the business of the corporation, or to make improvements, and to establish various reserves, if it is to the interests of the corporation to do so, and a court of equity will not interfere with or control their discretion in determining what the interests of the corporation require in this respect, unless there is a clear abuse of discretion.²⁰

Among the reserves which it may be prudent to establish before a surplus available for dividends is found are reserves for depreciation, repairs, bad accounts, unknown taxes, and fluctuations in business conditions. What proportion of the profits should be retained in the business and reinvested is an important question of business policy.²¹

§ 158. Right of corporations to pay dividends.—A corporation cannot lawfully reduce its capital stock by distributing any part thereof among the stockholders as dividends. The right to pay

¹⁹ *Continental Ins. Co. v. Reading Co.*, 259 U. S. 156, 66 L. Ed. 871, 42 Sup. Ct. 540; *New York, L. E. & W. R. Co. v. Nickals*, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; *Pratt v. Pratt, Read & Co.*, 33 Conn. 446; *Field v. Lamson & Goodnow Mfg. Co.*, 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136; *Williams v. Western U. Tel. Co.*, 93 N. Y. 162; *Hunter v. Roberts, Throp & Co.*, 83 Mich. 63, 47 N. W. 131; *Spear v. Rockland-Rockport Lime Co.*, 113 Me. 285, 93 Atl. 754, 6 A. L. R. 793.

²⁰ *McNab v. McNab & Harlin Mfg. Co.*, 62 Hun (N. Y.) 18, 41 N. Y. St. Rep. 906, 16 N. Y. Supp. 448, aff'd 133 N. Y. 687, 31 N. E. 627; *New York, L. E. & W. R. Co. v. Nickals*, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; *Williams v. Western U. Tel. Co.*, 93 N. Y. 162; *Pardee v. Harwood Elec. Co.*, 262 Pa. 68, 105 Atl. 48.

²¹ See on this subject, *Dewing, Financial Policy of Corporations*, vol. 3, ch. 4, p. 42.

dividends is restricted to surplus, and by some states to the excess remaining from the conduct of the business after paying taxes, operating expenses and fixed charges. Other states recognize surplus available for dividends derived from premiums received for stock or funds arising from reduction of capital stock.

It is a settled rule, even in the absence of any statutory provision, that a corporation cannot lawfully declare dividends out of its capital stock, and thereby reduce the same, or out of assets which are needed to pay the corporate debts. They can be declared only out of surplus over the capital stock.²² It is a question whether surplus is properly to be ascertained by deducting the amount of liabilities and nominal paid-up capital from the value of the company's assets, or whether profits should be estimated without regard to any loss or depreciation of capital. It is also a question whether under-payment or watering of stock must be made up by profits before paying dividends.

"Capital stock" of a corporation, in its strict and primary sense, means the funds or property contributed or agreed to be contributed by the subscribers to capital as the financial basis of the corporation's business. The term signifies those resources whose dedication to the carrying of the corporate enterprise is made the foundation for the issuance of certificates of stock and which become irrevocably devoted to the satisfaction of the obligations of the corporation.²³ The general rule is that there must be no withdrawal of paid-up capital and that no dividends may be declared except out of surplus. Surplus is sometimes defined as the excess of the assets over liabilities including in liabilities the

²² *Birch v. Cropper*, 14 App. Cas. 525; *Wood v. Dummer*, 3 Mason 308, Fed. Cas. No. 17944; *Taft v. Hartford, P. & F. R. Co.*, 8 R. I. 310, 5 Am. Rep. 575; *Hubbard v. Weare*, 79 Iowa 678, 44 N. W. 915; *Williams v. Boice*, 38 N. J. Eq. 364; *Lockhart v. Van Alstyne*, 31 Mich. 76, 18 Am. Rep. 156; *Davenport v. Lines*, 72 Conn. 118, 44 Atl. 17; *Park v. Grant Locomotive Works*, 40 N. J. Eq. 114, 3 Atl. 162. See *Machen, Corporations*, secs. 1313-1344, what funds are available for dividends.

²³ "Capital stock" means the funds contributed or agreed to be contributed by stockholders as the financial basis of corporate business, made usually through stock subscriptions. *Dodge v. Ford Motor Co.*, 204

Mich. 459, 470 N. W. 668, 3 A. L. R. 413; *Equitable Life Assur. Soc. of United States v. Union Pac. R. Co.*, 212 N. Y. 360, 106 N. E. 92, L. R. A. 1915 D 1052; *Dominguez Land Corp. v. Daugherty*, 196 Cal. 468, 238 Pac. 703; *Powers v. Detroit, G. H. & M. R. Co.*, 201 U. S. 543, 50 L. Ed. 860, 26 Sup. Ct. 556 (property which the corporation has received); *Stamford Trust Co. v. Yale & Towne Mfg. Co.*, 83 Conn. 43, 75 Atl. 90; *Smith v. Dana*, 77 Conn. 543, 60 Atl. 117, 69 L. R. A. 76, 107 Am. St. Rep. 51; *Hood Rubber Co. v. Commonwealth*, 238 Mass. 369, 131 N. E. 201 (contribution to funds of corporation permanently dedicated to the business enterprise).

par value of the issued stock. But it would seem that profits should be determined with reference to the amount of capital actually paid in rather than the nominal par value of the shares issued.

Some authorities declare that the total value of the assets of the corporation at the time it is proposed to declare a dividend must exceed the amount of its debts and liabilities, including among its liabilities the par value of its issued capital stock.²⁴ This seems to be a mistake. "All that is required is that the whole capital originally contributed by the shareholders shall be put into the business and kept there; that no part of it shall be taken out again, directly or indirectly and given back to the shareholders."²⁵

There are a number of well-considered cases which hold that surplus is to be determined with reference to capital actually paid in rather than with reference to the nominal par value of the stock issued. Thus if the stock was watered, that is, issued for good will and patents at an excessive valuation, earnings need not accumulate to an amount equal to the par value of the stock before there are net profits available for dividends. Dividends are justified if there is an excess of earnings over expenses for the current year. There is no requirement that watered stock be made actually worth its nominal or face value, or that the impairment of capital by losses in previous years first be made good before a corporation can have surplus profits available for dividends. The prohibition of the distribution of "capital stock" refers properly to the contributions or capital paid in by the stockholders.^{25a}

²⁴ *Davenport v. Lines*, 72 Conn. 118, 44 Atl. 17; *Equitable Life Assur. Soc. of United States v. Union Pac. R. Co.*, 212 N. Y. 360, 106 N. E. 92, L. R. A. 1915 D 1052; *Cox v. Leahy*, 209 N. Y. App. Div. 313, 204 N. Y. Supp. 741, 743; *Hyams v. Old Dominion Copper Mining & Smelting Co.*, 82 N. J. Eq. 507, 89 Atl. 37 (dictum to the effect corporation in order to determine surplus available for dividends must list stock issued at par among its liabilities); *Whittaker v. Amwell Nat. Bank*, 52 N. J. Eq. 400, 29 Atl. 203; *Peters v. United States Mortg. Co.*, 13 Del. Ch. 11, 114 Atl. 598; *Bank of Morgan v. Reid*, 27 Ga. App. 123, 107 S. E. 555; *Crawford v. Roney*, 130 Ga. 515, 61 S. E. 117; *Coleman v. Booth*, 268 Mo. 64,

186 S. W. 1021. See *Ohio General Corporation Act*, § 38.

²⁵ 2 *Morawetz, Corporations* (2nd Ed.), sec. 440; *Thompson, Corporations* (2nd Ed.), sec. 5305; 2 *Machen, Corporations*, sec. 1317. See *Cook, Corporations* (8th Ed.), sec. 546.

^{25a} *Goodnow v. American Writing Paper Co.*, 73 N. J. Eq. 692, 69 Atl. 1014; 72 N. J. Eq. 645, 66 Atl. 607; *Merchants' & Insurers' Reporting Co. v. Schroeder*, 39 Cal. App. 226, 178 Pac. 540; *Peters v. United States Mortg. Co.*, 13 Del. Ch. 11, 114 Atl. 598, 6 *Minnesota Law Rev.* 72 (\$3,000,000 par value stock issued for \$1,700,000); *Ammonia Soda Co., Ltd. v. Chamberlain*, [1918] 1 Ch. 266, 9 *Brit. Rul. Cas.* 819, 853n; *Verner v. General, etc., Trust Co.*, [1894]

There is no obligation on a corporation to make good capital which has been lost in previous years before dividends can be paid. The English courts hold that capital may be sunk and lost and yet the excess of current receipts over current expenses may be divided. Losses of one year are not carried to the profit and loss account of the next period. Each year is regarded as a separate unit.²⁶ In an English case ^{26a} \$100,000 was unexpectedly collected on promissory notes which had never been considered of any value and had never been entered as assets in the balance sheets of the company. The directors proposed to treat the whole sum as a windfall in the nature of an unexpected profit and divisible as dividends. The company was temporarily enjoined from distributing this fund until an accounting could be had of the year's operations. It might be offset by losses of that year and the results of the year's trading. According to this view "net profits" are the balance or surplus remaining after all costs and expenses for the fiscal year have been deducted from income and earnings. A corporation may take the excess of receipts over expenditures at the end of a year or given fiscal period, and distribute that as dividends regardless of depreciation, loss or shrinkage in the capital assets derived from stock in previous years.

While a corporation may pay in dividends all of the clear net profits in any year without first making good losses incurred in previous year, or even the wear and tear on fixed capital, yet directors may be negligent in paying dividends if no honest or reasonable man of business would think it prudent under the circumstances and in view of the financial needs of the corporation. This would not be on the ground, however, that it was a withdrawal of capital, but because it was negligent management. It is not easy to give definite rules as to what will constitute profits available for dividends and what debts and liabilities must first be provided for. "The term 'profit,' out of which dividends alone

2 Ch. 239; In re National Bank of Wales, [1899] 2 Ch. 629. See Conyngton Corporate Procedure 1037, 1070; Reiter, Profits, Dividends and the Law 75, 83.

²⁶ *Ammonia Soda Co. v. Chamberlain*, [1918] 1 Ch. 266, 9 Brit. Rul. Cas. 819, 853n (right to pay dividends out of subsequent profits without making good losses of capital of other years).

^{26a} *Foster v. New Trinidad Lake Asphalt Co.*, L. R. [1901] 1 Ch. 208, held: The question of what is profit

available for dividend depends upon the result of the whole accounts fairly taken for the year. Although dividends may be paid out of earned profits, notwithstanding a depreciation of capital, a realized accretion to the estimated value of one item of the capital assets, cannot be deemed to be profit divisible among the shareholders without reference to the result of the whole accounts fairly taken and the other business or assets of the company.

can properly be declared, denotes what remains after defraying every expense, including loans falling due, as well as the interest on such loans."²⁷ In some states statutes limit the payment of dividends to net profits, or funds remaining from the conduct of the business after paying taxes, operating expenses and fixed charges.²⁸ But in others surplus of assets over the capital paid in may be regarded and dealt with as profits, however derived, as from premiums²⁹ received on the sale of stock or from the reduction of the amount of outstanding stock.³⁰

²⁷ *Mobile & O. R. Co. v. Tennessee*, 153 U. S. 486, 38 L. Ed. 793, 14 Sup. Ct. 968. See also, *Hubbard v. Weare*, 79 Iowa 678, 44 N. W. 915; *Stevens v. United States Steel Corp.*, 68 N. J. Eq. 373, 59 Atl. 905; *Cratty v. Peoria Law Library Ass'n*, 219 Ill. 516, 76 N. E. 707; *In re Spanish Prospecting Co., Ltd.*, [1911] 1 Ch. 92, 20 Ann. Cas. 677, 683 note. "Net profits" denotes what remains after defraying every expense including loans falling due. *Thomas v. Matthews*, 94 Ohio St. 32, 55, 113 N. E. 669, 675, L. R. A. 1917 A 1068.

²⁸ *Merchants' & Insurers' Reporting Co. v. Schroeder*, 39 Cal. App. 226, 178 Pac. 540. Under California Civ. Code, sec. 309, the entire proceeds of the sale of shares constitutes capital, though at a premium. See 11 *Amer. Bar Ass'n Journal* 373; *Southern California Home Builders v. Young*, 45 Cal. App. 679, 188 Pac. 586. Mere advance in value of property prior to sale or estimated profits on contracts do not constitute surplus profits, under California Civ. Code, sec. 309.

²⁹ The payment of a dividend out of a fund created by the sale of stock at a premium has been approved. *Equitable Life Assur. Soc. of United States v. Union Pac. R. Co.*, 212 N. Y. 360, 106 N. E. 92, L. R. A. 1915 D 1052; *Smith v. Cotting*, 231 Mass. 42, 120 N. E. 177, 181; *Miller v. Payne*, 150 Wis. 354, 136 N. W. 811; *In re Hoare & Co., Ltd.*, [1904] 2 Ch. 208; *Union Pac. Life Ins. Co. v. Ferguson*, 64 Ore. 395, 129 Pac. 529, 130 Pac. 978, 43 L. R. A. (N. S.) 958. *Contra*, *Corliss v. United States*, 7 Fed. (2d) 455.

In *Equitable Life Assurance Soc. of United States v. Union Pac. R. Co.*, supra, the defendant retired a

bond issue at the rate of \$175 in bonds for one share of common stock of the par value of \$100. Thus on the issue of each share, a premium of \$75 was received. Plaintiff, a preferred stockholder, sued to restrain a dividend to common stock on the ground that the premium was an accretion to capital. The court allowed payment of the dividend on the ground that the premium became part of the surplus profits. See 14 *Columbia Law Rev.* 524.

In *Corliss v. United States*, 7 Fed. (2d) 455, 456, it is said: "As a general rule, corporations have no right to pay dividends out of any fund except the excess remaining from the conduct of the business after paying taxes, operating expenses, and fixed charges. *Mobile & O. R. Co. v. Tennessee*, 153 U. S. 486, 38 L. Ed. 793, 14 Sup. Ct. 968; 14 C. J. 800. This rule, however, is not universal. The supreme court of Massachusetts has approved the payment of a dividend out of a fund created by the sale of stock at a premium. *Smith v. Cotting*, 231 Mass. 42, 120 N. E. 177, 181. The Court of Appeals of New York says: 'When the property of a corporation has accumulated in excess of its chartered capital, the excess may be regarded and dealt with as constituting a surplus of profits.' *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257, 266, 77 N. E. 13, 16, 3 L. R. A. (N. S.) 1034, 112 Am. St. Rep. 607, 6 Ann. Cas. 213. See also, *Thompson, Corporations*, sec. 5307, and a scholarly article by Solicitor General Mitchell, 11 *Amer. Bar Ass'n Journal*, 377, 379, 380."

³⁰ Reduction of capital: *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257, 77 N. E. 13, 3 L. R. A. (N. S.) 1034,

The mere fact that a corporation is indebted does not prevent it from paying a dividend, if the fair value of its assets exceeds its indebtedness and there are surplus profits to the extent of the dividend declared.³¹ When a corporation, like a railroad company, has a bonded debt, representing money which it has put into its plant or works, etc., it must pay the interest thereon out of its earnings before payment of a dividend;³² but it need not pay the bonded indebtedness, for this is represented by its assets and is not a current expense in ascertaining net profits.³³ A sinking fund, however, should be provided for the payment of the bonded indebtedness as it falls due.³⁴

In the case of railroad companies and other corporations whose capital stock is invested in rolling stock, tracks, buildings, machinery, or other property which must become worn and depreciated in value in its use, and which will have to be repaired or renewed from time to time, the wear of the property and necessity for repairs must be taken into consideration in estimating profits for the purpose of declaring dividends, and a sufficient sum should be set aside to create a reserve fund for repairs and renewals.³⁵

112 Am. St. Rep. 667, 6 Ann. Cas. 213; *Strong v. Brooklyn Crosstown R. Co.*, 93 N. Y. 426; *Continental Securities Co. v. Northern Securities Co.*, 66 N. J. Eq. 274, 57 Atl. 876; *Benas v. Title Guaranty Trust Co.*, 216 Mo. App. 53, 267 S. W. 28. See *Dominguez Land Corp. v. Daughtery*, 196 Cal. 468, 238 Pac. 703, 44 A. L. R. 1. See 44 A. L. R. 40 note, on Rights of shareholders to surplus assets upon reduction of capital stock.

³¹ *Mills v. Northern Ry. of Buenos Ayres Co.*, 5 Ch. App. 621; *O'Shields v. Union Iron Foundry*, 93 S. C. 393, 76 S. E. 1098 (debts often represent investments).

As a general rule money cannot be borrowed for the purpose of paying dividends. *Davis v. Flagstaff Silver Min. Co. of Utah*, 2 Utah 74; *Thomas v. Matthews*, 94 Ohio St. 32, 55, 113 N. E. 669, L. R. A. 1917 A 1068. It has been held, however, that when a corporation has used profits out of which it might have paid a dividend in the improvement of its property, when it might have borrowed the money for such purposes, it may borrow the money to take the place of the profits so used, and use it in paying the dividend, for the dividend in

such a case is paid, in effect, out of the profits. *Excelsior Water & Mining Co. v. Pierce*, 90 Cal. 131, 27 Pac. 44. And if surplus profits have in fact been earned, and are invested in property used in the business of the corporation, or other assets not at present available for the purpose of distribution among the stockholders as a dividend, a dividend may properly be paid by borrowing money. *Stringer's Case* (In re Mercantile Trading Co., 4 Ch. App. 475; *Mills v. Northern Ry. of Buenos Ayres Co.*, 5 Ch. App. 621; *Frank Gilbert Paper Co. v. Frankard*, 195 N. Y. Supp. 638. ³² *Mobile & O. R. Co. v. Tennessee*, 153 U. S. 486, 38 L. Ed. 793, 14 Sup. Ct. 968; 14 C. J. 800.

³³ *Mills v. Northern Ry. of Buenos Ayres Co.*, 5 Ch. App. 621.

³⁴ See *Gratz v. Redd*, 4 B. Mon. (Ky.) 178; *Hazeltine v. Belfast & M. L. R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330.

³⁵ *Dent v. London Tramway Co.*, [1880] L. R. 16 Ch. Div. 344 (maintenance and repair); *Davidson v. Gillies*, 16 Ch. Div. 347, note. See also, *Whittaker v. Amwell Nat. Bank*, 52 N. J. Eq. 400, 29 Atl. 203; *People ex rel. Binghamton Light, Heat &*

The Ohio court says: "It is the duty of directors in determining the amount of net earnings available for dividends, to take into account the needs of the company in its business and sums necessary in the operation of its business until the income from further operations is available, the amount of debts, the necessity or advisability of paying its debts, or at least reducing them within the limits of the company's credit, the preservation of its capital stock as represented in the assets of the company as a fund for the protection of its creditors, and the character of its surplus assets, whether cash, credits or merchandise." ³⁶

When a corporation is created for the purpose of investing its capital in property which will necessarily be consumed or exhausted in the course of its operations, so that the depreciation in the value of the property cannot be repaired, as in the case of a mining company, it is not required to set aside funds to keep its wasting capital intact or replace it. A mining company is not formed for the purpose of permanently using the property in which its capital is invested, but for the purpose of exhausting the property which necessarily will be gradually consumed in making profits. In estimating the profits no deduction is to be made for depreciation in the value of its mine by reason of its use and consumption in taking out the ore or other minerals. Dividends may be lawfully declared out of the net proceeds of its operations after deducting expenses and debts and a reasonable fund for contingencies.³⁷ The rule also applies to other corporations created for the purpose of using a property which must necessarily become

Power Co. v. Stevens, 203 N. Y. 7, 22, 96 N. E. 114. But see Eyster v. Centennial Board of Finance, 94 U. S. 500, 24 L. Ed. 188 (depreciation of buildings need not be considered in estimating profits); 2 Machen, Corporations, sec. 1327.

³⁶ Thomas v. Matthews, 94 Ohio St. 32, 55, 113 N. E. 669, 673, L. R. A. 1917 A. 1068.

³⁷ Excelsior Water & Mining Co. v. Pierce, 90 Cal. 131, 27 Pac. 44; Baldwin v. Miller & Lux, 152 Cal. 454, 92 Pac. 1030. See also, Lee v. Neuchatel Asphalte Co., 41 Ch. Div. 1; Boothe v. Summit Coal Min. Co., 55 Wash. 167, 104 Pac. 207, 19 Ann. Cas. 1255; People ex rel. United Verde Copper Co. v. Roberts, 156 N. Y. 585, 51 N. E. 293; Stratton's Independence, Ltd. v. Howbert, 207 Fed. 419.

A mining company, however, cannot lawfully sell a part of its mine and declare a dividend out of the proceeds, or borrow money for the purpose of paying a dividend. Davis v. Flagstaff Silver Min. Co., 2 Utah 74. And see Wittenberg v. Federal Mining & Smelting Co., — Del. Ch. —, 133 Atl. 48, 75 Univ. Pa. Law Rev. 350 (dividends may not be declared on common stock of wasting asset corporation as against objection of preferred stockholders, where no provision is made to establish reserve against depletion of capital assets. Preferred stockholders who possess a prior claim on capital assets have an equity which entitles them to protection against dividends out of the proceeds of capital invested). See 12 Cornell Law Quart. 79.

exhausted in its use, as, for example, a corporation created for the purpose of utilizing a lease for a term of years, or a patent.³⁸

The rule that a corporation cannot reduce its capital stock by distributing any part of the same among its stockholders prevents a corporation from entering into an agreement to pay its stockholders interest upon the amount paid in by them on their shares, if there are no means except the capital stock out of which the interest can be paid, for the effect of such a transaction is to distribute among the stockholders a part of the capital stock.³⁹

§ 159. Mode of declaring and paying dividends.—Dividends are properly declared by formal action of the board of directors, entered upon the records of the corporation.

It is within the discretion of the directors of a corporation to pay dividends either in cash, or property, or bonds, or, if there is stock in reserve, or the capital stock may be increased, in stock; but if a dividend be made payable in cash or payable generally, the debt must be paid in lawful currency.

No discrimination can be made between stockholders in the mode of paying dividends.

A dividend is properly declared by formal action of the board of directors, or of the stockholders as a body, as the case may be, and the vote should appear on the records of the corporation.⁴⁰ It has been held that the declaration of a dividend cannot be proved by parol evidence in collateral suits between the corporation and stockholders, but only by the corporate records. If a dividend has in fact been declared, but does not appear on the records, the remedy is to correct the records, first in the corporation itself, by calling attention to the omission, or, where this will not avail, by *mandamus* to the proper officer, or by a suit in equity.⁴¹

³⁸ See the dictum in *Excelsior Water & Mining Co. v. Pierce*, 90 Cal. 131, 27 Pac. 44.

Preferred stockholders in the absence of contract, cannot require a sinking fund to be established to pay off their stock on dissolution, though the capital consists of patents that will expire and leave nothing. *Mellon v. Mississippi Wire Glass Co.*, 77 N. J. Eq. 498, 78 Atl. 710. See *Baldwin v. Miller & Lux*, 152 Cal. 454, 92 Pac. 1030. Compare *Wittenberg v. Federal Mining & Smelting Co.*, — Del. Ch. —, 133 Atl. 48, 75 Univ. Pa. Law

Rev. 89, 350; 40 Harvard Law Rev. 318; Del. Corp. Law, § 34.

³⁹ *Lockhart v. Van Alstyne*, 31 Mich. 76, 18 Am. Rep. 156; *Painesville & H. R. Co. v. King*, 17 Ohio St. 534.

⁴⁰ *American Wire Nail Co. v. Gedge*, 96 Ky. 513, 29 S. W. 353. See *Grant v. Ross*, 100 Ky. 44, 48, 37 S. W. 263; *Eaton v. English & Mersick Co.*, 7 Fed. (2d) 54; *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666, 36 Atl. 129, 61 Am. St. Rep. 805.

⁴¹ *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666, 36 Atl. 129, 61 Am. St. Rep. 805.

A division or distribution of profits by the consent of stockholders and directors in an informal manner is generally held to be in effect a dividend, and valid if creditors are not injured. The stockholders will be entitled to the amounts credited to them and the informality of the declaration will not prevent the stockholder from recovering even against the trustee if the corporation subsequently becomes bankrupt.⁴² If all the stockholders, including all the directors of a solvent corporation, meet and agree to a division of the profits, that is the equivalent of a dividend. It is made by common consent, though not formally declared.⁴³

Property dividends.—When a corporation possesses a surplus in excess of its capital, the directors in their discretion may distribute it in cash, or in bonds, or in property, or under some circumstances in stock. The Southern Pacific Co. held valuable oil lands which it wished to divide among its stockholders. It was not feasible to distribute them in kind, so the plan was adopted of organizing the Pacific Oil Co. and distributing the oil company's stock among the stockholders, charging them a portion of its value. This method of distribution of the property was held within the discretion of the governing body, the directors.⁴⁴ "There is no rule of law or reason founded upon public policy which condemns a property dividend. The directors could convert the property into cash before a dividend and divide that. So the stockholders can take the property divided to them and sell it and thus realize the cash. Within the domain of law, it can make no material difference which course is pursued. If, however, a dividend be made payable in cash or payable generally, the corporation becomes a debtor, and must discharge such debt, as it is bound to discharge all its other debts, in lawful currency."⁴⁵

⁴² Informal dividend held valid in *Smith v. Moore*, 199 Fed. 689; *Spencer v. Lowe*, 198 Fed. 961; *Quinn v. Quinn Mfg. Co.*, 201 Mich. 664, 167 N. W. 898; *Knight v. Alamo Mfg. Co.*, 190 Mich. 233, 157 N. W. 24, 6 A. L. R. 789; *Hartley v. Pioneer Iron Works*, 181 N. Y. 73, 73 N. E. 576; *Central of Georgia R. Co. v. Central Trust Co.*, 135 Ga. 472, 69 S. E. 708; *Breslin v. Fries-Breslin Co.*, 70 N. J. L. 274, 58 Atl. 313. See 26 Harvard Law Rev. 370.

⁴³ *Barnes v. Spencer & Barnes Co.*, 162 Mich. 509, 127 N. W. 752, 756,

139 Am. St. Rep. 587 (informal division of profits is a dividend); *Hartley v. Pioneer Iron Works*, 181 N. Y. 73, 73 N. E. 576; *Spencer v. Lowe*, 198 Fed. 961, 965; *Thiry v. Banner Window Glass Co.*, 81 W. Va. 39, 93 S. E. 958, L. R. A. 1918 B 1048; *Cook, Corporations* (8th Ed.) sec. 712.

⁴⁴ *Venner v. Southern Pac. Co.*, 279 Fed. 832, 840.

⁴⁵ *Williams v. Western U. Tel. Co.*, 93 N. Y. 162; *Grants Pass Hardware Co. v. Calvert*, 71 Ore. 103, 142 Pac. 569.

Bond or scrip dividends.—In the absence of statutory provision to the contrary, a corporation may use surplus profits in improvement of its property or in purchasing machinery or other property which it is authorized under its charter to acquire and hold, and issue its bonds as a method of distribution of such profits.⁴⁶ Or it may issue a scrip dividend, scrip being a writing or certificate issued to shareholders in lieu of a dividend, entitling them to money, stock, bonds, land, or other benefit at some future time,—“an interim or provisional document or certificate, to be exchanged, when certain payments have been made or conditions complied with, for a more formal certificate, as of shares or bonds, or entitling the holder to the payment of interest, a dividend, or the like.”⁴⁷

Stock dividends.—A stock dividend is a dividend payable in reserved or additional stock of the corporation, instead of in cash or in property.⁴⁸ If a corporation has issued all the shares of stock which its charter authorizes it to issue, and has no authority to increase its stock, it is clear that it cannot pay a stock dividend. It is otherwise, however, when a corporation has in reserve stock which it can lawfully issue, or when it is authorized to increase its capitalization. In such a case, in the absence of a constitutional or statutory prohibition, if the directors of the corporation, acting in good faith, are of the opinion that it is for the best interests of the corporation and its stockholders to retain profits in the business of the corporation, or as a surplus fund to meet future needs, instead of dividing them among the stockholders as a dividend in cash or property, it is within their discretion to do so, and to pay a dividend by issuing reserved or additional stock. Such a dividend is not in any sense a distribution of the capital stock of the corporation among the stockholders.⁴⁹

⁴⁶ *State v. Baltimore & O. R. Co.*, 6 Gill (Md.) 363; *Wood v. Lary*, 47 Hun (N. Y.) 550.

⁴⁷ *Century Dict. & Cyc.* “Scrip.” See *Rogers v. New York & T. Land Co.*, 134 N. Y. 197, 32 N. E. 27; *State v. Baltimore & O. R. Co.*, 6 Gill (Md.) 363; *Williams v. Western U. Tel. Co.*, 61 How. Pr. (N. Y.) 216, 9 Abb. N. C. 437; s. c., 93 N. Y. 162; *Chaffee v. Rutland R. Co.*, 55 Vt. 110; *In re Robinson's Trust*, 218 Pa. 481, 67 Atl. 775; *Barnes v. Spencer & Barnes Co.*, 162 Mich. 509, 127 N. W. 752, 139 Am. St. Rep. 587.

It is said in *Dewing's Financial Policy of Corporations*, that in some cases a scrip dividend is a mere device for postponing the unpleasant confession that the company is not able to pay any dividends at all.

⁴⁸ *Williams v. Western U. Tel. Co.*, 93 N. Y. 162 (a stock dividend is lawful if corporation has a surplus and issue of new stock is authorized). *Union & N. H. Trust Co. v. Taintor*, 85 Conn. 452, 83 Atl. 697.

⁴⁹ A stock dividend is not a dividend in the ordinary sense of a distribution of profits to stockholders as

In some jurisdictions there are constitutional or statutory prohibitions against issuing stock dividends, or limitations upon the power to issue them.⁵⁰ If a stock dividend does not represent surplus profits it is bonus stock and the holder of such stock may be accountable for its par value to subsequent creditors in event of insolvency. Usually the purpose and effect of a stock dividend is to capitalize surplus profits which are thus invested in the business in the permanent form of improvements or extensions. The proportionate interest of each shareholder remains the same as before. It has been held that a stock dividend cannot be taxed by Congress as income of the stockholder,⁵¹ because the

income. *Lancaster Trust Co. v. Mason*, 152 N. C. 660, 68 S. E. 235, 136 Am. St. Rep. 851; *Palmer v. Pullman Co.*, 252 Fed. 286; *Security Trust Co. v. Rammelsburg*, 82 W. Va. 701, 97 S. E. 122; *Sexton v. G. L. Percival Co.*, 189 Iowa 586, 177 N. W. 83; *Williams v. Western U. Tel. Co.*, 93 N. Y. 162. See *Jones v. Terre Haute & Richmond R. Co.*, 57 N. Y. 196; *Davis v. Jackson*, 152 Mass. 58, 25 N. E. 21, 23 Am. St. Rep. 801; *Farwell v. Great Western Tel. Co.*, 161 Ill. 522, 44 N. E. 891.

As in the case of a cash or property dividend, a stock dividend can only be issued to represent surplus profits. The assets of the corporation, over and above its debts, etc., must be equal to the amount of the new stock added to the amount of the original capital stock. *Williams v. Western U. Tel. Co.*, 93 N. Y. 162; *In re Heaton's Estate*, 89 Vt. 550, L. R. A. 1916 D 201, 96 Atl. 21; *Joyce v. Congdon*, 114 Wash. 239, 195 Pac. 29.

⁵⁰ *Grafton County Elec. Light & Power Co. v. State*, 77 N. H. 539, 94 Atl. 193. See Illinois Const., Art. XI, sec. 13; *Cook, Corporations* (8th Ed.), sec. 536.

Under a constitutional or statutory provision that no corporation shall issue stock except for money, labor done, or money or property actually received, and all fictitious increase of stock shall be void, it was held that a corporation with a capital stock of ten thousand dollars had no authority to double its capital stock, and distribute the new stock among its stockholders as a stock dividend, on the mere statement that its capital stock

"has been invested in property which has more than doubled in value, and is now worth \$20,000 over and above all liabilities." *Fitzpatrick v. Dispatch Publishing Co.*, 83 Ala. 604, 2 So. 727. See *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788; *Whitlock v. Alexander*, 160 N. C. 465, 76 S. E. 538; *Anglo-American Land, Mortgage & Agency Co. v. Lombard*, 132 Fed. 721.

⁵¹ *Eisner v. Macomber*, 252 U. S. 189, 211, 64 L. Ed. 521, 40 Sup. Ct. 189, 9 A. L. R. 1570; *Warren*, 34 Harv. Law Rev. 885. See *Ballantine*, 34 Harvard Law Rev. 573, 586; *T. R. Powell*, 5 Bulletin Nat. Tax Ass'n, No. 7 (April 1920). Compare *State ex rel. Dulaney v. Nygaard*, 174 Wis. 597, 183 N. W. 884.

A distribution of the shares of another corporation would of course be a property dividend, an actual transfer of assets of the company among its shareholders. *Peabody v. Eisner*, 247 U. S. 347, 349, 62 L. Ed. 1152, 38 Sup. Ct. 546. See *Union & New Haven Trust Co. v. Traintor*, 85 Conn. 452, 83 Atl. 697.

E. H. Warren, Taxability of stock dividends as income, 33 Harvard Law Rev. 885: "At the formation of a corporation, five thousand shares of its stock, each of a par value of \$100, were issued for \$500,000. The business of the corporation was successfully conducted; some of its profits were distributed from time to time to its stockholders, and the balance was carried to surplus account; its net assets came to be worth \$1,000,000, so that it had a capital of \$500,000 and a surplus of \$500,000; the directors believed it wise not to dis-

mere issue of a stock dividend makes the recipient no richer than before. Nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders for their separate use and benefit. The stock dividend evinces merely a transfer of accumulated surplus, which might have been distributed, to the capital account of the corporation. The only change for the shareholder is in the evidence of his interest, the number of his certificates and not in the value of his holdings. A declaration of a stock dividend is entirely different from a distribution of earnings. "When a stock dividend is paid, that which was surplus becomes capital. A fund available for dividends is converted into a fund not available for dividends. The payment of a stock dividend is not only not a present distribution of earnings, but it destroys all possibility of a future distribution therefrom. . . . The rights of the stockholder are diminished and the rights of the corporation are increased. By the capitalization of the surplus, corporate control of the assets (profits) is perpetuated."⁵²

Discrimination between stockholders.—A corporation has no right, in paying dividends, to exclude any stockholder, or to discriminate between stockholders.⁵³

tribute this surplus to the stockholders, but to retain it permanently in the business; they therefore paid a stock dividend of 100 per cent. Thus the surplus was capitalized. A fund out of which dividends might have been paid to the stockholders at the discretion of the directors became part of the corporate capital, and so a part of funds out of which dividends might never be paid.

"Before the payment of the stock dividend, the book value of each share was \$200. After the payment of the stock dividend, the book value of each share was \$100. Before the dividend, a stockholder had, say, one hundred shares; each of these shares had a book value of \$200, so that the total book value of his shares was \$20,000. After the dividend, this stockholder has two hundred shares; each of these shares has a book value of \$100, so that the total book value of his shares remains at \$20,000. The stockholder has precisely the same fractional in-

terest in the corporate undertaking that he had before. It is obvious that the book value of a stockholder's holdings cannot be increased a penny by a stock dividend."

⁵² E. H. Warren, *Taxability of stock dividends as income*, 33 *Harvard Law Rev.* 885.

⁵³ "The dividends must be general on all the stock, so that each stockholder will receive his proportionate share. The directors have no authority to declare a dividend on any other principle. They cannot exclude any portion of the stockholders from an equal participation in the profits of the company." *Ryder v. Alton & Sangamon R. Co.*, 13 Ill. 516; *Cratty v. Peoria Law Library Ass'n*, 219 Ill. 516, 76 N. E. 707; *Thiry v. Banner Window Glass Co.*, 81 W. Va. 39, 93 S. E. 958, L. R. A. 1918 B 1048. Compare as to co-operative associations, *Mooney v. Farmers' Mercantile & Elevator Co.*, 138 Minn. 199, 164 N. W. 804.

Time of payment of dividends.—It is within the discretion of the directors to fix the time for payment of a dividend.⁵⁴ If no time is fixed by the resolution declaring a dividend, it is payable on demand,⁵⁵ and if the resolution declares that it shall be payable at such time as the board of directors may direct, and the board fixes no time, the law implies that it shall be paid within a reasonable time.⁵⁶

§ 160. **Persons who are entitled to dividends—In general.**—Every owner of shares of stock in a corporation at the time a dividend is declared is entitled to share ratably therein, unless there is some agreement to the contrary.

When shares are transferred, either absolutely or as collateral security, the transferee or pledgee is entitled, in the absence of agreement to the contrary, to all dividends declared after the transfer, but not to dividends declared before, although not payable until afterwards.

But if stock is transferable only on the books of the company, the corporation will not be liable if it pays a dividend to the person appearing on the books as the owner of shares, although the shares may have been transferred, unless it has notice of the transfer.

A legatee of shares, unless the will provides otherwise, is entitled to dividends declared after the testator's death, but not to dividends declared before, although payable afterwards.

It is an undoubted general rule that, in the absence of agreement to the contrary, all persons who own shares of stock in a corporation at the time a dividend is declared are entitled, as a matter of absolute right, to share ratably in the dividend in proportion to their respective shares, regardless of the time when their shares were acquired, and the corporation cannot make any discrimination, or otherwise deprive any one of them of this right.⁵⁷ One who

⁵⁴ *Richter & Co. v. Light*, 97 Conn. 364, 116 Atl. 600; *Williams v. Western U. Tel. Co.*, 93 N. Y. 162.

⁵⁵ *State v. Baltimore & O. R. Co.*, 6 Gill (Md.) 363.

⁵⁶ *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Northwestern Marble & Tile Co. v. Carlson*, 116 Minn. 438, 133 N. W. 1014, Ann. Cas. 1913 B 552; *Wallin v. Johnson City Lumber & Mfg. Co.*, 136 Tenn. 124, 188 S. W. 577, L. R. A. 1917 B 323. The doubt-

ful question in these cases is whether the declaration by the directors was intended to be final. If it was not, the relief given amounts to compelling the declaration of a dividend.

⁵⁷ *Richter & Co. v. Light*, 97 Conn. 364, 116 Atl. 600; *Jackson's Adm'rs v. Newark Plank Road Co.*, 31 N. J. Law 277; *Boardman v. Lake Shore & M. S. Ry. Co.*, 84 N. Y. 157; *Goodwin v. Hardy*, 57 Me. 143, 99 Am. Dec. 758; *March v. Eastern R. Co.* 43

receives stock from a corporation immediately before a dividend is declared has the same right as the other stockholders to share therein, unless he is excluded by the terms of his contract.⁵⁸

In the case of an executory contract to sell stock, it is generally held that the purchaser of the stock, and not the seller, is entitled to the dividends declared after the contract is made.⁵⁹ Although it may not be correct to say that the purchaser is even an equitable owner prior to payment and delivery of the certificate, yet it is a fair construction of the agreement that the parties intended the shares to be transferred in their condition at the time of the bargain and not diminished in value by dividends. But in mere options it is otherwise.

Right to dividend on transfer of stock.—In general any dividend already declared when stock is transferred belongs to the transferor and does not pass by the transfer; and the fact that the dividend is made payable at a future day does not alter the rule.⁶⁰ The A corporation declared a dividend and paid it to those stockholders who were registered as such on the books of the corporation. B, a former stockholder, had sold and assigned his stock to C before the declaration of the dividend, but C had not yet had the stock transferred into his name. What are C's rights against A and B? As between B and C, the latter is entitled. The A corporation is not liable to C, at least in the absence of notice. The general rule for determining the person to whom a dividend is payable is that it belongs to the substantial or beneficial owner of the shares at the time the dividend is declared, and not to the owner at the time of its payment.⁶¹ The reason is that when a

N. H. 515; *Corgan v. George F. Lee Coal Co.*, 218 Pa. 386, 67 Atl. 655, 120 Am. St. Rep. 891, 11 Ann. Cas. 838.

⁵⁸ *Jones v. Terre Haute & Richmond R. Co.*, 29 Barb. (N. Y.) 353, 57 N. Y. 196, where the holder of bonds of a corporation convertible at any time into stock exchanged them for stock just before the declaration of a dividend.

⁵⁹ *Bank of Waverly v. Daily*, 103 Neb. 7, 170 N. W. 183; *La Fountain & Woolson Co. v. Brown*, 91 Vt. 340, 101 Atl. 36, L. R. A. 1917 F 551, 553n; *Hubbard v. George*, 81 W. Va. 538, 94 S. E. 974, L. R. A. 1918 C 835; *Rossi v. Rex Consol. Min. Co.*, 108 Wash. 296, 183 Pac. 120. But see *Gilfallan v. Gilfallan*, 168

Cal. 23, 141 Pac. 623, Ann. Cas. 1915 D 784.

⁶⁰ *Richter & Co. v. Light*, 97 Conn. 364, 116 Atl. 600; *Wallin v. Johnson City Lumber & Mfg. Co.*, 136 Tenn. 124, 188 S. W. 577, L. R. A. 1917 B 323, 326n; *Fletcher, Corporations*, secs. 3699, 3802. Compare as to stock dividends, *Allith-Prouty Co. v. Wallace*, 32 Wyo. 392, 233 Pac. 144, 234 Pac. 504, 39 A. L. R. 513.

⁶¹ *Lobaco Co. v. Chaffin*, 193 Ky. 225, 235 S. W. 993 (subsequent sale of stock does not carry dividend already declared, although dividend is not payable until after the sale or transfer). *Western Securities Co. v. Silver King Consol. Min. Co. of Utah*, 57 Utah 88, 192 Pac. 664.

declaration is made, the corporation becomes a debtor and the right of the stockholder to the distribution becomes fixed by the declaration. The payment is usually postponed for the convenience of the corporation. The transferee will be entitled, as an incident to his ownership of the stock, to all dividends declared after the transfer, though the profits out of which they are declared may have been earned by the corporation before the transfer, while the transferrer is entitled to all dividends declared before the transfer, although they may not be payable until afterwards.⁶² In an English case, dividends which have been declared are likened to fallen fruit, which does not pass under a sale or gift of the tree.⁶³ While the law permits the seller to retain the fallen fruit, it does not accord him the additional privilege of shaking the tree after the bargain is closed. Dividends declared subsequent to the transfer of ownership belong to the transferee.⁶⁴

Effect of terms of declaration.—What is the effect on the rights of the transferee where the vote declaring the dividend specifies the time and manner for determining the stockholders entitled to the dividends? Frequently in the resolution declaring a dividend there is a clause that the dividend shall be payable to those who are stockholders of record on a specified future date. Is this merely for the protection of the corporation or is it in substance a declaration that the vote shall confer a right as to stockholders on that date and not earlier? Some cases hold that the declaration is prospective, and in favor of those who are stockholders at the time specified.⁶⁵

⁶² *Wheeler v Northwestern Sleigh Co.*, 39 Fed. 347; *Bowers v. Post*, 209 Fed. 660; *Bright v. Lord*, 51 Ind. 272, 19 Am. Rep. 732; *Boardman v. Lake Shore & M. S. Ry. Co.*, 84 N. Y. 157, 178; *Jermain v. Lake Shore & M. S. R. Co.*, 91 N. Y. 483; *Robertson v. De Brulatour*, 188 N. Y. 301, 80 N. E. 938; *Hopper v. Sage*, 112 N. Y. 530, 20 N. E. 350, 8 Am. St. Rep. 771; *Kaufman v. Charlottesville Woolen Mills Co.*, 93 Va. 673, 25 S. E. 1003; *Gemmell v. Davis*, 75 Md. 546, 23 Atl. 1032, 32 Am. St. Rep. 412.

This rule applies to preferred stock and to stock dividends, as well as to cash dividends. *Jermain v. Lake Shore & M. S. R. Co.*, 91 N. Y. 483; *Coleman v. Columbia Oil Co.*, 51 Pa. St. 74. See note on Right to divi-

dends on transfer of stock in L. R. A. 1917 B 323, 326.

⁶³ *De Gendre v. Kent*, L. R. 4 Eq. 283.

⁶⁴ *La Fountain & Woolson Co. v. Brown*, 91 Vt. 340, 101 Atl. 36, L. R. A. 1917 F 551; *Hubbard v. George*, 81 W. Va. 538, 94 S. E. 974, L. R. A. 1918 C 835 n.

⁶⁵ *Ford v. Ford Mfg. Co.*, 222 Ill. App. 76, 87; 2 *Cook, Corporations* (8th Ed.), sec. 539 (dividend made payable in instalments during period of a year to owners of stock at time the deferred payments should be made, exception to general rule that dividends belong to owners of stock at the time of declaration of the dividend); *Nutter v. Andrews*, 246 Mass. 224, 142 N. E. 67; s. e., 140 N. E.

In a North Carolina case,⁶⁶ the directors declared a six per cent dividend on the 16th day of February to be paid, half on April 1 and half on July 1, the transfer books to be closed March 1 to April 1 and June 1 to July 1. On February 17, B sold and transferred his stock to W, to whom the company paid the April dividend over B's protest. It was held that the purchaser W, who bought before the books closed, acquired the dividend as an incident of the stock. The object of closing the books was to put the dividend to the credit of holders on March 1 or June 1. But it has been held in other cases that a resolution declaring a dividend which makes it payable at some time in the future to stockholders of record on a certain day is intended to serve the convenience of the corporation and to protect it in paying to the persons who appear on its books where it has no notice of transfer. It will not affect title to the dividend between seller and buyer of the stock. In spite of a usage of the New York stock exchange that a dividend already declared goes with the stock until the date of closing of the books, the law is that the dividend becomes the property of the owners of the stock when declared, no matter whether payable immediately or at a future time. A sale of the stock does not pass it as an incident.⁶⁷

744, noted in 8 Minnesota Law Rev. 541; 38 Harvard Law Rev. 246; Richter & Co. v. Light, 97 Conn. 364, 116 Atl. 600 (the declaration fixes the rights and the stockholder on the day set is entitled to the dividend).

Where dividends had been voted during the life of the beneficiary for life, but in favor of stockholders of record as of a date after her death, and payable at a still later date, the dividends were held to go to the residuary legatee and not to the estate of the life tenant. The date of passing the vote does not furnish the test, since another date is specified in the resolution when the debt arises. Nutter v. Andrews, 246 Mass. 224, 142 N. E. 67, 38 Harvard Law Rev. 246; 8 Minnesota Law Rev. 541.

⁶⁶Burroughs & Springs v. North Carolina R. Co., 67 N. C. 376, 12 Am. Rep. 611. The object in declaring the transfer books of the company closed from March 1 to April 1 was to put the dividend to the credit of the holders on March 1. The effect of the resolution was to make the divi-

dend payable to whomever should appear to be owner on the days when it was made payable. Lancaster Trust Co. v. Mason, 152 N. C. 660, 68 S. E. 235, 136 Am. St. Rep. 851 (stock dividend).

⁶⁷Hopper v. Sage, 112 N. Y. 530, 20 N. E. 350, 8 Am. St. Rep. 771; Ford v. Snook, 205 N. Y. App. Div. 194, 199 N. Y. Supp. 630; Wallin v. Johnson City Lumber & Mfg. Co., 136 Tenn. 124, 126, 188 S. W. 577, L. R. A. 1917 B 323. See Chaplin, 13 Columbia Law Rev. 401, 38 Harvard Law Rev. 247; 8 Minnesota Law Rev. 541.

According to the rules and customs of the New York Stock Exchange, dividends declared pass with the stock until the time of closing of the books. After that the stock sells or passes "ex dividend." See Rules of the New York Stock Exchange, art. 32; 38 Harvard Law Rev. 247. But it has been held that the seller does not clothe the broker with authority to sell his stock with the "dividend on," in accordance with a custom of which he had no knowledge. Ford v. Snook,

Transfers not made on books of corporation.—Where, for the protection of the corporation, it is expressly provided that the shares are not transferable except on the books of the corporation, and that dividends are payable to the stockholders of record, the corporation is not bound to look beyond its books, assuming that they have been kept properly, to determine who is entitled to dividends, but it may safely pay them to those persons who appear on the books to be shareholders, and it will be protected in such payment, notwithstanding transfers made before the dividend was declared, but which had not been entered upon its books, and of which it had no notice.⁶⁸ The transferee of course may recover the amount collected from the transferor, as he is entitled to all dividends declared after the transfer. The corporation itself may be liable if it has notice of the transfer. In such a case, if it pays the dividend to the person appearing on its books as owner, it remains liable to the transferee, whether the transfer was absolute or merely as collateral, notwithstanding his omission to have his transfer registered.⁶⁹ The transferee cannot sue for a dividend until he has duly applied for a transfer of the stock to his name on the corporate records.

Rights of pledgees.—In the absence of agreement to the contrary, a pledge of shares of stock as collateral security carries with it, as an incident of the pledgee's special ownership, the right to receive dividends afterwards declared, to be applied on the debt, or held in trust for the pledgor. If the transfer has been registered on the books of the corporation, or, although not so registered, if the corporation has notice thereof, it will be liable to the pledgee if it pays such dividends to the pledgor.⁷⁰

205 N. Y. App. Div. 194, 199 N. Y. Supp. 630.

⁶⁸ Richter & Co. v. Light, 97 Conn. 364, 116 Atl. 600; Brisbane v. Delaware, L. & W. R. Co., 94 N. Y. 204; Cleveland & M. R. Co. v. Robbins, 35 Ohio St. 483; Donnally v. Hearndon, 41 W. Va. 519, 23 S. E. 646; Dennett v. Acme Mfg. Co., 106 Me. 476, 76 Atl. 922; Campbell v. Perth Amboy Mut. Loan Homestead & Building Ass'n, 76 N. J. Eq. 347, 356, 74 Atl. 144; 14 C. J. 819, 820. See Uniform Stock Transfer Act, § 3.

⁶⁹ Robinson v. National Bank, 95 N. Y. 637; Jones v. Terre Haute & R. R. Co., 57 N. Y. 196; Boyd v. Conshohocken Worsted Mills, 149 Pa.

St. 363, 24 Atl. 287; Gemmell v. Davis, 75 Md. 546, 23 Atl. 1032, 32 Am. St. Rep. 412; Timberlake v. Shippers' Compress Co., 72 Miss. 323, 16 So. 530; Guarantee Co. of North America v. East Rome Town Co., 96 Ga. 511, 23 S. E. 503, 51 Am. St. Rep. 150; Prince Investment Co. v. St. Paul & S. C. Land Co., 68 Minn. 121, 70 N. W. 1079; Steel v. Island Milling Co., 47 Ore. 293, 83 Pac. 783.

⁷⁰ Boyd v. Conshohocken Worsted Mills, 149 Pa. St. 363, 24 Atl. 287; Brightson v. Clafin, 225 N. Y. 469, 122 N. E. 458; National Bank of Commerce in St. Louis v. Equitable Trust Co. of New York, 227 Fed. 526; Gemmell v. Davis, 75 Md. 546, 23

Rights of legatees.—A specific legatee of shares of stock is entitled to all dividends declared after the testator's death, although out of profits earned before, but he is not entitled, unless by express provision in the will, to dividends declared before the testator's death, although not payable until afterwards. Such dividends form part of the *corpus* of the estate, and go to the executor.⁷¹ But it has been held that where dividends were declared before testator's death, payable according to the directors' resolution to stockholders of record at a later date, by which time the stock had passed to the residuary legatee under the will, that the dividends were payable to the legatee who owned the stock at the specified time.⁷²

§ 161. **Rights of preferred stockholders.**—The right of holders of preferred stock to dividends depends, of course, upon the terms of their contract. Ordinarily—

- (1) They are entitled to receive the specified dividend before the payment of any dividend on the common stock.
- (2) Dividends on preferred stock, although guaranteed, are payable only out of net earnings or surplus profits available for the purpose of paying dividends.
- (3) Unless a restriction to each year's profits appears, dividends on preferred stock are cumulative, and arrearages in one year are payable in subsequent years, when there are sufficient profits, before dividends can be paid on the common stock.
- (4) Non-cumulative preferred stock has certain rights in profits if earned in any particular year, even if dividends are not declared in that year.
- (5) Ordinarily it is for the directors to determine whether the condition of the corporation is such that a dividend on preferred stock may be declared; but if they abuse their discretion, a court of equity will compel them to declare a dividend.

Atl. 1032, 32 Am. St. Rep. 412; Guarantee Co. of North America v. East Rome Town Co., 96 Ga. 511, 23 S. E. 503, 51 Am. St. Rep. 150.

⁷¹ De Gendre v. Kent, L. R. 4 Eq. 283; Brundage v. Brundage, 65 Barb. (N. Y.) 397, 1 Thomp. & C. 82, aff'd 60 N. Y. 544; Phelps v. Farmers' &

Mechanics' Bank, 26 Conn. 269; In re Kernochan, 104 N. Y. 618, 11 N. E. 149.

⁷² Nutter v. Andrews, 246 Mass. 224, 142 N. E. 67; s. c., 140 N. E. 744; 38 Harvard Law Rev. 247; 8 Minnesota Law Rev. 541.

- (6) Participation of preferred with common in surplus earnings may be impliedly excluded.
- (7) Distributive share on dissolution may be preferred.

Ordinary preferred stock, as we have seen, is stock upon which the holders are entitled to certain dividends before payment of any dividends to the holders of the common stock.⁷³ Preferred stock is presumably protected by a large investment of the common stockholders. It is given a first claim to the profits available for distribution, and this may be the consideration for a return limited to a fixed rate. Often preferred stock fully covers the tangible assets, and the common stock is issued for business good will, patents and the hopeful expectation of earning capacity. This makes the preferred really like common stock, with all the risks of the business but without the speculative chances of the common. It is a favorite device in corporation finance to get some one else to take all the risks for a small share of the possible profits. Preferred stock is sometimes sold on the basis of there being no prior liens, but it has the weakness of being subject to any bonds, notes, bank loans or floating debt which may thereafter be created. Restrictions are sometimes imposed on the issue of bonds, or subsequent issues of preferred stock, or the creation of an excessive floating debt, without the consent of a large percentage of the preferred stock.⁷⁴

Participating preferred stock.—The extent of the preference depends, of course, upon the terms of the contract under which the stock is issued. Preferred stock may be made participating, that is, may be entitled, after payment of the preferred dividend, to share equally with the common stockholders in any further dividends that may be declared.⁷⁵ “Participating preferred stock may be generally defined as corporate stock according the holder a definite preference as to dividends up to a fixed amount (which may be called ‘initial preferred dividends’) with or without cumulative provisions, or preference as to assets on liquidation, and also carrying rights to additional dividends (which may be called ‘dividends

⁷³ Ante, § 141; *Wright v. Johnston*, 183 Iowa 807, 167 N. W. 680. The preference feature consists merely in the restriction upon the power of the corporation to pay dividends on the common stock until prior payment to the preferred.

⁷⁴ *Dewing*, *Financial Policy of Corporations*, vol. I, chap. VI. See 27 *Columbia Law Rev.* 587.

⁷⁵ *Gordon's Ex'rs v. Richmond, F. & P. R. Co.*, 78 Va. 501; *Berle*, *Participating preferred stock*, 26 *Columbia Law Rev.* 303.

in participation') based upon a sharing of the corporate earnings between holders of the preferred and holders of junior classes of stock. Essentially such securities are hybrid, bridging a gap between preferred and common stocks, and having some of the dividend rights inherent in both."⁷⁶ The terms of the certificates of preferred stock are not the only evidence of the contract, but these must be read in connection with the statutes, articles of incorporation and by-laws; all these enter in and form part of the contract between the corporation and the preferred stockholders.⁷⁷

Dividends payable out of profits only.—Preferred stockholders, as was explained in a former chapter, are not creditors of the corporation, even though the specified dividends may in terms be "guaranteed," so as to be entitled to dividends irrespective of the condition of the corporation and the existence of profits.⁷⁸ On the contrary, they are stockholders, and in the same position substantially as the other stockholders, except as to the right to a preference. And it is well settled that they are entitled to dividends only when there are surplus profits or net earnings out of which dividends may lawfully be paid, as in the case of common stockholders.⁷⁹

⁷⁶ Berle, Participating preferred stock, 26 Columbia Law Rev. 303, 317: "This participation may rank equally with the rights of common stock. Or it may be postponed after a prior right to common stock, ranking equally with subsequent rights of common stock. Or it may be postponed to prior rights of common stock, and be followed by other junior rights of common stock."

Ashbury v. Watson, 30 Ch. Div. 376; Belfast & M. L. R. Co. v. Belfast, 77 Me. 445, 1 Atl. 362; Fidelity Trust Co. v. Lehigh Valley R. Co., 215 Pa. 610, 64 Atl. 829, 7 Ann. Cas. 613.

⁷⁷ Continental Ins. Co. v. Minneapolis, St. P. & S. S. M. Ry. Co., 290 Fed. 87, 91, 31 A. L. R. 1320.

⁷⁸ Ante, § 142.

Preferred stockholders are creditors only by virtue of statute or by contract by which they are deprived of the rights of stockholders. Hazel Atlas Glass Co. v. Van Dyk & Reeves, Inc., 8 Fed. (2d) 716, 723: "There are some cases in which the holders of

preferred stock have been recognized as having certain rights which belong to creditors. These cases have rested upon exceptional statutes conferring upon the holders of the stock rights which belong to creditors, and which would not be possessed by the holders of the stock, were it not for the statutory authorization. Thus a statute in Maryland authorized the issue of preferred stock and gave to the holders priority over subsequent mortgages. Heller v. National Marine Bank, 89 Md. 602, 43 Atl. 800, 45 L. R. A. 438, 72 Am. St. Rep. 212; Rogers v. Citizens' Nat. Bank, 93 Md. 613, 49 Atl. 843."

See ante, § 141; 6 A. L. R. 812, 817n.

⁷⁹ Birch v. Cropper, 14 App. Cas. 525; Knight v. Alamo Mfg. Co., 190 Mich. 223, 157 N. W. 24, 6 A. L. R. 789; New York, L. E. & W. R. Co. v. Nickals, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; Field v. Lamson & Goodnow Mfg. Co., 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136; Kingston Cotton Mills v. Wachovia

The right of stockholders to dividends is entirely different from the right of bondholders or creditors to interest. Even preferred stockholders cannot force the directors to pay dividends in a particular year if they see fit to use the funds in the business in the fair and honest exercise of their discretion. The fact that the dividends are in terms "guaranteed" does not change this rule so as to render them payable absolutely and unconditionally.⁸⁰ "It is not a debt that is guaranteed, but the right to a dividend from the earnings and income of the corporation. . . . There is no debt until the dividend is declared. The obligation and right to declare it does not arise until there is a fund from which it can properly be made."⁸¹ The principles upon which it is to be determined whether there are net earnings or surplus profits for the purpose of paying a dividend are precisely the same in the case of preferred stock as in the case of common stock, and have been considered in former sections.⁸²

Cumulative and noncumulative dividends.—The A company for three years made no profits and declared no dividends upon either the preferred or common stock. During the past year it has made a large surplus and proposes to declare the regular annual dividend of 7 per cent on the preferred stock, and a dividend of 8 per cent on the common. The preferred stockholders contend that they are entitled to dividends for the three years in which no dividends were paid them before anything can be paid upon the common

Bank & Trust Co., 185 N. C. 7, 115 S. E. 883, 29 A. L. R. 251. See 6 A. L. R. 810n.

⁸⁰ Taft v. Hartford, P. & F. B. Co., 8 R. I. 310, 5 Am. Rep. 575; Chaffee v. Rutland R. Co., 55 Vt. 110; Lockhart v. Van Alstyne, 31 Mich. 76, 18 Am. Rep. 156; Field v. Lamson & Goodnow Mfg. Co., 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136.

A contract to pay a stockholder dividends out of capital stock, or to pay absolutely and unconditionally, whether there are profits or not, is illegal and void as against creditors and as against the corporation. Guinness v. Land Corporation of Ireland, 22 Ch. Div. 349; Memphis Grain & Package Elevator Co. v. Memphis & C. R. Co., 85 Tenn. 703, 5 S. W. 52, 4 Am. St. Rep. 798.

⁸¹ Chaffee v. Rutland R. Co., 55 Vt. 110. See Cotting v. New York & N.

E. R. Co., 54 Conn. 156, 5 Atl. 851; Collins v. Portland Elec. Power Co., 7 Fed. (2d) 221.

In Hazel Atlas Glass Co. v. Van Dyk & Reeves, Inc., 8 Fed. (2d) 716, 719, it is said: "The general rule is that a holder of preferred stock, even though the preferred dividend is guaranteed, is not regarded as a creditor of the corporation, and entitled as such to share with the other creditors in the distribution of the assets. He is, like the holders of the common stock, merely a stockholder, but with this difference, that he is entitled to priority of payment out of the assets which remain after all debts are paid, the holders of the common stock sharing in such assets as are left."

⁸² Ante, § 158, and cases there cited; Dent v. London Tramways Co., 16 Ch. Div. 344.

stock. Is this correct? It depends on whether the dividends are cumulative or noncumulative. The presumption is that preferred dividends are intended to be cumulative.⁸³

It is a great advantage to preferred stock to have the dividends made cumulative. Sometimes the dividends upon preferred stock are in express terms made to depend upon the profits of each particular year, so that the holders of the stock will not be entitled to any dividends in a particular year if there are not enough profits in that year to pay the same, or will be entitled only in so far as there are profits. In such a case, the dividends are not cumulative, and are not to be made up out of the profits, although sufficient, of subsequent years.⁸⁴ In declaring dividends on preferred stock, the arrearages of one year cannot be paid out of the earnings of a subsequent year, when the charter or by-laws require the entire net earnings of each year to be paid out in dividends. In such a case, the preferred stock is noncumulative.⁸⁵

It has been supposed by some that in case of noncumulative preferred stock, if the dividend in any one year is "passed" or omitted, all right to it is forever lost. For instance, it has been asserted that if sufficient surplus profits exist from which a dividend might be paid, but the directors carry them over to working capital, the preferred stock is juggled out of a dividend, for if these noncumulative dividends are not paid in any one year they are lost

⁸³ Unless a contrary intention appears, dividends on preferred stock are cumulative, and arrearages in one year are payable in subsequent years when there are sufficient profits, before dividends may be paid on the common. *Hazel Atlas Glass Co. v. Van Dyk & Reeves, Inc.*, 8 Fed. (2d) 716, 720; *Fidelity Trust Co. v. Lehigh Valley R. Co.*, 215 Pa. 610, 64 Atl. 829, 7 Ann. Cas. 613; *Lockwood v. General Abrasive Co.*, 210 N. Y. App. Div. 141, 205 N. Y. Supp. 511. See note to *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257, 77 N. E. 13, 6 Ann. Cas. 213, as to right of holder of preferred stock to cumulative dividends. See also *Collins v. Portland Elec. Power Co.*, 12 Fed. (2d) 671 (whether dividends are cumulative depends on express provision); 6 *Fletcher, Corporations*, sec. 3754; 1 *Cook, Corporations* (8th Ed.), sec.

273; 1 *Machen, Corporations*, sec. 551.

⁸⁴ See *Dent v. London Tramways Co.*, 16 Ch. Div. 344; *New York, L. E. & W. R. Co. v. Nickals*, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; *Hazeltine v. Belfast & M. L. R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330; *Elkins v. Camden & A. R. Co.*, 36 N. J. Eq. 233; *Burk v. Ottawa Gas & Electric Co.*, 87 Kan. 6, 123 Pac. 857, Ann. Cas. 1913 D 772; 14 C. J. p. 421. The right of such holders to dividends is conditional upon the earning of sufficient profits each year to meet the dividend of that year.

⁸⁵ *Hazeltine v. Belfast & M. L. R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330. See also, *Elkins v. Camden & A. R. Co.*, 36 N. J. Eq. 233; *Staples v. Eastman Photographic Materials Co.*, [1896] 2 Ch. 303.

entirely, and go to the benefit of the holders of the common stock and the bondholders.⁸⁶

But it would seem that it is not within the discretion of the board of directors whether the noncumulative preferred stockholders shall receive dividends or not when sufficient net profits are earned.⁸⁷ The United States Cast Iron Pipe Company accumulated a "reserve for additional working capital," during five years, part of which was obtained by scaling down dividends on the noncumulative 7 per cent preferred stock. A common stockholder sought to restrain the corporation from paying dividends on the preferred except out of profits made during that year. The court held that the fund, in so far as it represented profits retained from preferred dividends, was available for subsequent dividends on the preferred. But the directors could not accumulate a fund at the expense of the common stock for the benefit of the preferred stockholders.⁸⁸ "If the board of directors, in the exercise of their discretion, see the necessity for building up a surplus or for expending earnings on extensions or improvements, they are free to do so. The right of the noncumulative stockholders is confined to

⁸⁶ Conyngton, *Corporate Procedure*, sec. 484; Conyngton, *Corporate Organization* 82. See *Burk v. Ottawa Gas & Electric Co.*, 87 Kan. 6, 123 Pac. 857, Ann. Cas. 1913 D 772.

⁸⁷ *Collins v. Portland Elec. Power Co.*, 7 Fed. (2d) 221 (dividends earned but not paid on the noncumulative stock must be paid before dividends on the common stock). See right of noncumulative preferred stockholders to back dividends earned but unpaid, 74 Univ. Pa. Law Rev. 605. See also, 34 Yale Law Journal 657; 11 Virginia Law Rev. 553; Berle, 23 Columbia Law Rev. 358; 23 Michigan Law Rev. 779; 38 Harvard Law Rev. 686; 27 Columbia Law Rev. 53.

In *Collins v. Portland Elec. Power Co.*, 7 Fed. (2d) 221, 228, aff'd, 12 Fed. (2d) 671, it is said: "The conclusion reached is that, when there was an accumulation of net surplus sufficient, after satisfying all prior preferred cumulative demands, to pay the interest or any part of it for any given year upon the second preferred stock, the holders thereof earned their interest to that extent for the year, and of right were entitled to their dividends, which could not be defeated by the board of directors, except by

setting aside the surplus for legitimate corporate purposes, and that a mere postponement of payment did not impair the right."

The time of payment, however, is discretionary. *New York, L. E. & W. R. Co. v. Nickals*, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; *Belfast & M. L. R. Co. v. Belfast*, 77 Me. 445, 1 Atl. 362. Cf. *Burk v. Ottawa Gas & Electric Co.*, 87 Kan. 6, 123 Pac. 857, Ann. Cas. 1913 D 772; *Hazeltine v. Belfast & M. L. R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330.

⁸⁸ *Bassett v. United States Cast Iron Pipe & Foundry Co.*, 75 N. J. Eq. 539, 73 Atl. 514.

Withheld noncumulative dividends must be paid before dividends on the common stock. *Moran v. United States Cast Iron Pipe & Foundry Co.* (*Day v. United States Cast Iron Pipe & Foundry Co.*), 95 N. J. Eq. 389, 123 Atl. 546, aff'd 96 N. J. Eq. 698, 736, 126 Atl. 302, 309, 326; *Bassett v. United States Cast Iron Pipe & Foundry Co.*, 74 N. J. Eq. 668, 70 Atl. 929; *Collins v. Portland Elec. Power Co.*, 7 Fed. (2d) 221, 226, aff'd 12 Fed. (2d) 671. See 27 Columbia Law Rev. 53.

the crediting in their favor of back earnings so used. What may be called a 'dividend credit' is set up in favor of noncumulative stockholders. . . . This 'dividend credit' takes priority over the dividend rights of common stockholders."⁸⁹

In an article on Noncumulative Preferred Stock,⁹⁰ Mr. A. A. Berle, Jr., lays down the following propositions: "Holders of noncumulative stock have rights in any surplus profits of the corporation accumulated by failure to declare the preferred dividend provided for in the charter when such dividend or any part thereof has been earned."⁹¹

"Out of the surplus net profits of each year, an amount equal to the noncumulative preferred dividend provided for in the charter, or whatever part of such dividend has been earned, less whatever dividend has been declared and paid or set apart upon the noncumulative preferred stock, although it may be used in the corporate business, must be segregated on the books for the benefit of such preferred stock. It can never be distributed as dividends to the common stock.

"All or part of the dividends earned upon but not paid to the preferred stock, may be paid at any later time to the preferred stockholders out of the preferred surplus fund.

"It is held that the corporation has made a forthright promise to pay such dividends, when earned; and that if the promise has been unfulfilled in the past, the corporation must repair past breaches as soon as there is opportunity."⁹²

"When dissolution impends, a court of equity should compel the distribution of the entire preferred surplus fund among the preferred stockholders upon a proper bill to compel the declaration and payment of dividends."

⁸⁹ Right of noncumulative preferred stockholders to back dividends earned but unpaid, 74 Univ. Pennsylvania Law Rev. 605, 609: "To illustrate: if in a particular year the 6 per cent noncumulative preferred stock earned nothing, no credit is erected; if earnings are 4 per cent, which the board does not wish to pay immediately, a credit to that extent in favor of the noncumulative stock is carried on the books of the company; if more than 6 per cent is earned, the whole 6 per cent dividend must be credited, and the surplus is available for the common stock."

⁹⁰ 23 Columbia Law Rev. 360.

⁹¹ Citing, *Bassett v. United States Cast Iron Pipe & Foundry Co.*, note 88, 74 N. J. Eq. 668, 670, 70 Atl. 929, 75 N. J. Eq. 539, 73 Atl. 514; *Elkins v. Camden & A. B. R.*, 36 N. J. Eq. 233.

⁹² Citing *New York, L. E. & W. R. Co. v. Nickals*, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; *American Steel Foundries v. Lazear*, 204 Fed. 204; *Staples v. Eastman Photographic Materials*, L. R. 2 Ch. 303 (semble).

If the contract with the preferred stockholders guarantees or entitles them in general terms to a certain annual dividend, not making the dividend payable in each year dependent upon the profits of that year, the dividends are cumulative. If the profits in any year are not sufficient to pay the dividend, it must be paid, in addition to subsequent dividends, out of the profits of subsequent years, before any dividends can be paid to the holders of common stock.⁹³ No dividend may be declared on the common stock until all back dividends have been made up on the preferred.

Discretion in declaring dividends.—What has been said in a former section as to the discretion of the directors in declaring or refusing to declare dividends⁹⁴ applies to preferred stock, as well as common stock. Even as to noncumulative preferred, when the dividends for a particular year are made dependent upon the profits of that year, as declared by the board of directors, it is primarily for the board of directors to determine whether the condition of the company in any particular year is such as to warrant the declaration of a dividend, and the courts will not interfere unless an abuse of discretion is shown.⁹⁵ If the directors abuse their discretion, however, and refuse to declare a dividend when it

⁹³ *Henry v. Great Northern Ry. Co.*, 27 L. J. Ch. 1, 3 Jur. (N. S.) 1133, 44 Eng. Reprint 858; *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257, 77 N. E. 13, 3 L. R. A. (N. S.) 1034, 112 Am. St. Rep. 607, 6 Ann. Cas. 213; *Boardman v. Lake Shore & M. S. Ry. Co.*, 84 N. Y. 157; *Jermain v. Lake Shore & M. S. R. Co.*, 91 N. Y. 483; *Hazeltine v. Belfast & M. L. R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330; *Lockhart v. Van Alstyne*, 31 Mich. 76, 18 Am. Rep. 156; *Spear v. Rockland-Rockport Lime Co.*, 113 Me. 285, 93 Atl. 754, 6 A. L. R. 793, 813n. See 64 Univ. Pennsylvania Law Rev. 521.

In *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257, 77 N. E. 13, 3 L. R. A. (N. S.) 1034, 112 Am. St. Rep. 607, 6 Ann. Cas. 213, it is held that preferred stockholders have no right to any surplus created by the reduction of capital stock. These are not "surplus profits arising from the business of the corporation" within the agreement with respect to dividends on the preferred stock, and are not

applicable to the arrears of unpaid dividends.

⁹⁴ Ante, § 157. See *Spear v. Rockland-Rockport Lime Co.*, supra, note 93.

⁹⁵ *New York, L. E. & W. R. Co. v. Nickals*, 119 U. S. 296, 30 L. Ed. 363, 7 Sup. Ct. 209; *Field v. Lamson & Goodnow Mfg. Co.*, 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136; *Belfast & M. L. R. Co. v. Belfast*, 77 Me. 445, 1 Atl. 362; *Spear v. Rockland-Rockport Lime Co.*, 113 Me. 285, 93 Atl. 754, 6 A. L. R. 793, 803 note; *McLean v. Pittsburgh Plate Glass Co.*, 159 Pa. St. 112, 28 Atl. 211. Compare *Storrow v. Texas Consolidated Compress & Mfg. Ass'n*, 87 Fed. 612; *Hazeltine v. Belfast & M. L. R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330; *Burk v. Ottawa Gas & Electric Co.*, 87 Kan. 6, 123 Pac. 857, Ann. Cas. 1913 D 772. 1 *Cook, Corporations* (8th Ed.), sec. 272: "Courts are inclined to scan closely a refusal to declare dividends where there are net profits and where the preferred stock is noncumulative."

is clear that there are surplus profits available for the purpose, they are subject to the control of a court of equity in a suit by the preferred stockholders to compel them to declare and pay a dividend.⁹⁶ There is a limit to the discretion of directors in applying all its profits to plant, equipment and extensions to the exclusion of paying dividends. If the accumulated profits exceed the capital stock or the needs of the business, and if it appears that there is some scheme to enhance the interests of the common at the expense of the preferred stock, or to coerce the holders of minority stock to dispose of their holdings a bill may be maintained to compel the declaration of dividends.⁹⁷

Participation of preferred with common in surplus.—The A Co. has a large surplus in a prosperous year and has paid the holders of the preferred stock the amount of dividend specified, viz., 8 per cent., and has paid a like amount on the common stock. The directors now propose to divide the balance of the surplus proportionately between the common and preferred. The holders of the common stock assert that the preferred stock has no right to participate in profits above the fixed rate of dividend, viz., 8 per cent.

The view has been adopted by some courts that preferred stock is entitled to share equally with the common stock in any distribution of profits after the common stock has received in the same year a dividend at the same rate as that stipulated as a preference for the preferred.⁹⁸ Another view, however, is strongly supported to the effect that where there is no stipulation in reference to participation in the surplus, that the preferred is entitled to its fixed percentage only.⁹⁹ It seems a reasonable inference that in con-

⁹⁶ *Hazeltine v. Belfast & M. L. R. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330; *Storrow v. Texas Consol. Compress & Mfg. Ass'n*, 87 Fed. 612; *Griffing v. A. A. Griffing Iron Co.*, 61 N. J. Eq. 269, 48 Atl. 910.

⁹⁷ *Storrow v. Texas Consol. Compress & Mfg. Ass'n*, 87 Fed. 612; *Griffing v. A. A. Griffing Iron Co.*, 61 N. J. Eq. 269, 48 Atl. 910.

⁹⁸ Some cases hold that in the absence of any limitation the preferred stock is entitled to participate equally with the common in any distribution of profits after the common stock has received an amount equal in rate for the same period as the preferred.

Englander v. Osborne, 261 Pa. 366, 104 Atl. 614, 6 A. L. R. 800, 829 note. See *Star Pub. Co. v. Ball*, 192 Ind. 158, 134 N. E. 285; *Sternbergh v. Brock*, 225 Pa. 279, 74 Atl. 166, 24 L. R. A. (N. S.) 1078, 133 Am. St. Rep. 877. See 3 Minnesota Law Rev. 65; 19 Michigan Law Rev. 463, Thompson. The view of these courts is that the preferred stockholder is entitled to all the rights of the common stockholder, except as restricted by statute or contract.

⁹⁹ In *Stone v. United States Envelope Co.*, 119 Me. 394, 111 Atl. 536, 13 A. L. R. 422, it is held that a preferred stockholder who had received

sideration of his preferential rights, the preferred stockholder impliedly agrees to accept a fixed rate in lieu of equal participation with the common. Of course, the contract of the preferred stockholder may call for participation.¹⁰⁰ There are various types of participating preferred stock, which bridge the gap between preferred and common stock and have some of the dividend rights appropriate to each.¹⁰¹

Stock and scrip dividends.—When preferred stockholders are entitled, after payment of the preferred dividend, to share with the common stockholders in any further dividend, they are entitled to share in a stock or scrip dividend declared out of surplus profits used in improvements, or retained by the corporation.¹⁰²

Rights of transferees.—In the absence of an agreement to the contrary, a transfer of preferred stock, like a transfer of common stock, whether absolute or as a pledge, carries with it the right to all dividends declared after the transfer, but not dividends declared before the transfer; and it carries, in the absence of agreement to the contrary, the right to receive arrears of dividends when a dividend shall be declared.¹⁰³

the specified rate of dividend was not entitled to participate with the common stockholders in the distribution of surplus assets. "In receiving the greater security of his preferential rights, the preferred stockholder impliedly agrees to accept such rights in lieu of equal participation." It is generally understood that preferred shares are given a fixed return to the exclusion of further participation.

Niles v. Ludlow Valve Mfg. Co., 202 Fed. 141. See *Scott v. Baltimore & O. R. Co.*, 93 Md. 475, 49 Atl. 327; *Respective Rights of Preferred and Common Stockholders in Surplus Profits*, Thompson, 19 Michigan Law Rev. 468.

¹⁰⁰ *Continental Ins. Co. v. Minneapolis, St. P. & S. S. M. Ry. Co.*, 290 Fed. 87, 91, 31 A. L. R. 1320. See ante, notes 75, 76.

¹⁰¹ *Berle, Participating Preferred Stock*, 26 Columbia Law Rev. 303. There are four main types of participation in surplus with common after the preferred dividend of stated

amount; also preferences as to participation on dissolution, etc. See *Lockwood v. General Abrasive Co.*, 210 N. Y. App. Div. 141, 205 N. Y. Supp. 511.

¹⁰² *Gordon's Ex'rs v. Richmond, F. & P. R. Co.*, 78 Va. 501. See *Borg v. International Silver Co.*, 2 Fed. (2d) 910. If preferred stock is non-participating, an issuance of common stock on a *pro rata* basis to holders of common and preferred stock at less than its value will be enjoined at the suit of the common stockholders. Where the corporation has a substantial surplus, and the common stock has a book value of \$480 per share, such distribution would give the preferred stockholders a slice of the surplus which should enure to the common. See 20 Illinois Law Rev. 288.

¹⁰³ *Boardman v. Lake Shore & M. S. Ry. Co.*, 84 N. Y. 157; *Jermain v. Lake Shore & M. S. R. Co.*, 91 N. Y. 483; *Bates v. Androscoggin & K. R. Co.*, 49 Me. 491. See ante, § 160.

Remedies of preferred stockholders.—As in the case of common stockholders, preferred stockholders have no *legal* right to any part of the profits of the corporation until a dividend has been declared, and before then they cannot maintain an action at law against the corporation.¹⁰⁴ They may maintain an action at law against the corporation after a dividend has been declared.¹⁰⁵ Preferred stockholders may maintain a suit in equity for relief if the corporation attempts to pay a dividend to the common stockholders before payment of the stipulated dividend on the preferred stock, or to compel the directors to declare and pay a dividend on the preferred stock where they abuse their discretion in refusing to do so.¹⁰⁶

Distributive share of preferred stock.—It is the general common-law rule that the stockholders, common and preferred, share alike in the assets of a liquidating corporation if the preference is only as to dividends.¹⁰⁷ Upon winding up a corporation preferred shareholders are not entitled to a preference in the payment of their shares over common stock, where the terms of the preferred stock do not import a preference as to capital, but only as to dividends.¹⁰⁸ Undivided earnings are to be regarded as capital assets and to be so distributed on liquidation. A surplus of capital remaining upon the reduction of the capital stock of a corporation because of business losses cannot be used to satisfy the claims of preferred shareholders as to arrears of cumulative dividends. Their only right would be to share in the capital assets ratably with common stockholders. Dividends are not payable out of capital.¹⁰⁹

¹⁰⁴ Williston v. Michigan S. & N. I. R. Co., 13 Allen (Mass.) 400; ante, § 157; American Steel Foundries v. Lazear, 204 Fed. 204. See In re Interborough Consol. Corp., 277 Fed. 455.

¹⁰⁵ Ante, § 157; West Chester & P. R. R. v. Jackson, 77 Pa. 321; Chaffee v. Rutland, 55 Vt. 110.

¹⁰⁶ Boardman v. Lake Shore & M. S. Ry. Co., 84 N. Y. 157; Thompson v. Erie R. Co., 45 N. Y. 468; Hazeltine v. Belfast & M. L. R. Co., 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330; Gordon's Ex'rs v. Richmond, F. & P. R. Co., 81 Va. 621; s. c., 78 Va. 501; Spear v. Rockland-Rockport Lime Co., 117 Me. 285, 93 Atl. 754, 6 A. L. R. 793, 832n; Star Pub. Co. v. Ball, 192 Ind. 158, 134 N. E. 285;

Cratty v. Peoria Law Library Ass'n, 219 Ill. 516, 76 N. E. 707.

¹⁰⁷ Continental Ins. Co. v. United States, 259 U. S. 156, 181, 66 L. Ed. 871, 42 Sup. Ct. 540, 548.

¹⁰⁸ Lloyd v. Pennsylvania Elec. Vehicle Co., 75 N. J. Eq. 263, 539, 72 Atl. 16, 21 L. R. A. (N. S.) 228, 138 Am. St. Rep. 557, 20 Ann. Cas. 119, 76 N. J. Eq. 343, 72 Atl. 440, 21 L. R. A. (N. S.) 228, rev'g Hellman v. Pennsylvania Elec. Vehicle Co., 73 N. J. Eq. 269, 67 Atl. 834. See notes, 29 A. L. R. 256, 33 A. L. R. 1257, 1260.

¹⁰⁹ Roberts v. Roberts-Wicks Co., 184 N. Y. 257, 77 N. E. 13, 3 L. R. A. (N. S.) 1034, 112 Am. St. Rep. 607, 6 Ann. Cas. 213.

Preferred stock may be issued which holds out not only the inducement of dividends from the profits, if any, in preference to any dividend on the common stock, but also in case of dissolution or distribution of assets, if the anticipated profits have proved insufficient to produce the preferred dividends, that it shall receive the arrears of dividends upon the distribution of the capital assets in preference to any distribution of such assets to the common stockholders. It has been held that the rule that dividends cannot be paid out of capital is applicable to a going concern, and not to a final distribution.¹¹⁰ The right of preferred shareholders to participate in the distribution of surplus assets above the par value of the stock seems to be still unsettled, but the English courts treat this as a separate question from the right to participate in surplus earnings by way of dividends. They recognize a *prima facie* right to participate with common stock in surplus assets, unless expressly or impliedly taken away by the contract.¹¹¹ Holders of preferred stock may be entitled to priority in distribution of assets over common stock by contract, but not as against creditors. A provision for the repurchase or redemption of the preferred stock cannot be enforced to the prejudice of creditors.¹¹²

§ 162. Remedies for unlawful payment of dividends.—The remedies when the directors of a corporation unlawfully pay or threaten to pay dividends are as follows:

- (1) Dividends unlawfully paid may be recovered back by the corporation or its trustee in bankruptcy, or, in equity, by creditors.

¹¹⁰ *Johnson v. Johnson & Briggs*, 138 Va. 487, 122 S. E. 100 (preferential claim to assets for face of stock and for cumulative dividends, though not earned). Cf. *In re Springbok Agr. Estates, Ltd.*, [1920] 1 Ch. 563, 123 Law Times Rep. (N. S.) 322; *Michael v. Cayey-Caguas Tobacco Co.*, 190 N. Y. App. Div. 618, 180 N. Y. Supp. 532; 6 Cornell Law Quarterly 103; 34 Harvard Law Rev. 303. Arrears of preferential dividends held not payable out of capital where no profits earned and no dividends declared, and the amount remaining after payment of the preferred shares not being sufficient to pay the par value of the common stock.

¹¹¹ *In re Fraser and Chalmers, Ltd.*, [1919] 2 Ch. 114, a provision merely

giving preference shareholders priority for repayment of their capital in a winding up does not negative their ordinary right as stockholders to participate in surplus assets. *In re Espuela Land & Cattle Co.*, [1909] 2 Ch. 187. See 55 Canada Law Journal 216; *Niles v. Ludlow Valve Mfg. Co.*, 196 Fed. 994; *Continental Ins. Co. v. United States*, 259 U. S. 156, 181, 66 L. Ed. 871, 42 Sup. Ct. 540.

¹¹² *Booth v. Union Fibre Co.*, 142 Minn. 127, 171 N. W. 307. A corporation agreed to redeem its preferred stock at par after ten years. It was held that the redemption could not be enforced at a time when the corporation was insolvent, and the effect would be to imperil creditors. See 29 A. L. R. 254, 258n.

- (2) A stockholder, or perhaps a creditor, may sue in equity to enjoin unlawful payment of a dividend, or to compel its repayment.
- (3) Directors are liable to the corporation, and, in equity or under statutes, to creditors, for unlawfully paying dividends, if they have acted in bad faith or negligently, but not otherwise.

Recovery of dividends unlawfully paid.—If the directors of a corporation declare and pay a dividend to its stockholders, when there are no profits out of which a dividend may lawfully be declared, the stockholders have no right to retain the money received by them, and, as a rule, it may be recovered from them by the corporation.¹¹³ The A corporation had done business at a loss, and had no surplus profits above its paid-in capital. Nevertheless, for three years it declared and paid dividends to its stockholders. The corporation is now insolvent and unable to pay its creditors in full. Can the creditors recover from the stockholders the dividends which they have received from the capital of the corporation? If a corporation refuses to sue to recover dividends paid out of the capital stock, a stockholder may file a bill to compel repayment.¹¹⁴ Creditors of the corporation, or a receiver, or a trustee in bank-

¹¹³ *Lexington Life, Fire & Marine Ins. Co. v. Page*, 17 B. Mon. (Ky.) 412, 66 Am. Dec. 165; *Williams v. Boice*, 38 N. J. Eq. 364; *Gratz v. Redd*, 4 B. Mon. (Ky.) 178; *Wood v. Dummer*, 3 Mason 308, Fed. Cas. No. 17944; *Davenport v. Lines*, 72 Conn. 118, 44 Atl. 17; *Hayden v. Thompson*, 71 Fed. 60; *Bank of St. Marys v. St. John Powers & Co.*, 25 Ala. 566; *Fort Payne Bank v. Alabama Sanitarium*, 103 Ala. 358, 15 So. 647; *Hastings v. Drew*, 76 N. Y. 9; *Bartlett v. Drew*, 57 N. Y. 587; *Panhandle Nat. Bank v. Emery*, 78 Tex. 498, 15 S. W. 23; *Reading Trust Co. v. Reading Iron-Works*, 137 Pa. St. 282, 21 Atl. 169, 170; *Grant v. Ross*, 100 Ky. 44, 37 S. W. 263; *In re National Bank of Wales* [1899] 2 Ch. 629.

It has been held that an action at law will not lie by a receiver or assignee to recover back dividends unlawfully paid by an insolvent corporation out of the capital stock, but that the only remedy is in equity. *Vose v. Grant*, 15 Mass. 505; *Spear v. Grant*,

16 Mass. 9; *Paschall v. Whitsett*, 11 Ala. 472; *Lawrence v. Greenup*, 97 Fed. 906. But see contra, *Overland Sioux City Co. v. Clemens*, 189 Iowa 1293, 179 N. W. 954.

The fact that a statute makes directors individually liable to the corporation or its creditors for wrongfully paying dividends when there are no profits available for the purpose does not affect the liability of stockholders to repay dividends wrongfully received by them, and, notwithstanding such a statute, the liability of the stockholders may be enforced in equity by a receiver of the corporation. *Williams v. Boice*, 38 N. J. Eq. 364.

¹¹⁴ *Holmes v. Newcastle-upon-Tyne Freehold Abattoir Co.*, 1 Ch. Div. 682. See post, § 188 et seq.; *Gager v. Paul*, 111 Wis. 638, 87 N. W. 875. See *Minnesota Thresher Mfg. Co. v. Langdon*, 44 Minn. 37, 46 N. W. 310; *Detroit Trust Co. v. Goodrich*, 175 Mich. 168, 141 N. W. 882, Ann. Cas. 1915 A 821.

ruptey may also sue to recover the funds so unlawfully withdrawn.¹¹⁵ According to the better opinion, to sustain such a recovery, there need not have been any bad faith or negligence on the part of the directors in declaring the dividend.¹¹⁶ Nor need the stockholders have known that the dividend was declared and paid out of capital. However innocent their intention may have been, according to many decisions, dividends paid to them out of capital at a time when the corporation had no surplus profits, owed debts, but was nevertheless solvent, can be recovered back for the benefit of those creditors who presumably dealt with the corporation in reliance on its capital being unimpaired.¹¹⁷

This doctrine seems to be reasonable, and necessary to the protection of creditors of corporations. It is difficult to see how it can work any injustice to stockholders, even though they may have received the money in good faith, since they are merely compelled to refund what they were not entitled to receive. The doctrine was repudiated, however, in a case in the Supreme Court of the United States. It was there held that, since the assets of a solvent corporation are not a trust fund for creditors, stockholders of a corporation, not being also directors, who in good faith receive dividends declared by the directors while the corporation is a solvent and going concern, cannot be made to refund in an action by a receiver of the corporation after it becomes insolvent, although the dividend may have been unlawfully paid when there were no surplus profits, and therefore out of capital. And this was held, notwithstanding a statute prohibiting the corporation, or any member thereof, from withdrawing or permitting to be withdrawn, either in the form of dividends or otherwise, any portion of its capital, on the ground that this provision was not intended to apply to a

¹¹⁵ See cases cited in note 114, supra; *Mackall v. Pocock*, 136 Minn. 8, 161 N. W. 228, L. R. A. 1917 C 390 (recovery of unearned dividends by trustee in bankruptcy); *Brooks v. Buys*, 217 Mich. 263, 186 N. W. 472; *Fricke v. Angemeier*, 53 Ind. App. 140, 101 N. E. 329.

¹¹⁶ *Lexington Life, Fire & Marine Ins. Co. v. Page*, 17 B. Mon. (Ky.) 412, 66 Am. Dec. 165; *Detroit Trust Co. v. Goodrich*, 175 Mich. 168, 141 N. W. 882, Ann. Cas. 1915 A 821.

¹¹⁷ *Mackall v. Pocock*, 136 Minn. 8, 161 N. W. 228, L. R. A. 1917 C 390;

Brooks v. Buys, 217 Mich. 263, 186 N. W. 472; *American Steel & Wire Co. v. Eddy*, 130 Mich. 266, 89 N. W. 952; s. c., 138 Mich. 403, 101 N. W. 578; *Lexington Life, Fire & Marine Ins. Co. v. Page*, 17 B. Mon. (Ky.) 412, 66 Am. Dec. 165; *Finn v. Brown*, 142 U. S. 56, 35 L. Ed. 936, 12 Sup. Ct. 136; *Fort Payne Bank v. Alabama Sanitarium*, 103 Ala. 358, 15 So. 618; *In re Denham*, 25 Ch. Div. 752. Compare *In re Peruvian Guano Co.* [1894] 3 Ch. 690. Compare *Montgomery v. Whitehead*, 40 Colo. 320, 90 Pac. 509, 11 L. R. A. (N. S.) 230.

mere stockholder receiving in good faith a dividend declared by the directors of a solvent corporation out of capital.¹¹⁸

A director or other officer of a corporation is bound to know the condition of the corporation's affairs, and if he receives a dividend which has not been earned, it may be recovered from him by the corporation or its receiver or assignee.¹¹⁹ An officer who receives a dividend which was fraudulently or unlawfully declared is liable to the corporation therefor, although he may have repudiated the transaction after his receipt of the dividend, and repaid it to another officer, for he should repay it to the corporation.¹²⁰

Injunction.—If the directors of a corporation threaten to pay a dividend when there are no profits out of which it may lawfully be paid, any stockholder may maintain a suit in equity on behalf of himself and other stockholders to enjoin them.¹²¹ It has also been held that such a suit may be maintained by a creditor of the corporation.¹²²

Liability of directors.—The directors of a corporation charged with the management of its affairs occupy a relation analogous to that of trustees, and they are certainly liable to the corporation for any breach of trust.¹²³ This principle applies if they unlawfully pay dividends when there are no surplus profits available for their payment, and thereby reduce the capital stock, provided they act in bad faith, or are guilty of gross negligence or inattention. In such a case they incur liability, not only to the corporation, but also, in equity, to creditors.¹²⁴ There is no liability, however, either

¹¹⁸ *McDonald v. Williams*, 174 U. S. 397, 43 L. Ed. 1022, 19 Sup. Ct. 743. See also, *Lawrence v. Greenup*, 97 Fed. 906; *Ratcliffe v. Clendenin*, 232 Fed. 61; *Carlisle v. Ottley*, 143 Ga. 797, 85 S. E. 1010. If the corporation was insolvent when the dividend was paid, recovery of the amount may be had in spite of the stockholders' good faith. *Hayden v. Williams*, 96 Fed. 279. See note, 8 *Columbia Law Rev.* 303.

¹¹⁹ *Finn v. Brown*, 142 U. S. 56, 35 L. Ed. 936, 12 Sup. Ct. 136; *E. L. Moore & Co. v. Murchison*, 226 Fed. 679; *Davenport v. Lines*, 72 Conn. 118, 44 Atl. 17. And see *Gratz v. Redd*, 4 B. Mon. (Ky.) 178; *Rance's Case*, 6 Ch. App. 104. Compare *In re Denham*, 25 Ch. Div. 752.

¹²⁰ *Finn v. Brown*, 142 U. S. 56, 35 L. Ed. 936, 12 Sup. Ct. 136, aff'g 34 Fed. 124.

¹²¹ *Davison v. Gillies*, 16 Ch. Div. 347, note; *Macdougall v. Jersey Imperial Hotel Co.*, 2 Hem. & M. 528; *Carpenter v. New York & N. H. R. Co.*, 5 Abb. Pr. (N. Y.) 277; *Couquard v. National Linseed Oil Co.*, 171 Ill. 480, 49 N. E. 563; *Kingston v. Home Life Ins. Co. of America*, 11 Del. Ch. 258, 101 Atl. 898.

¹²² *Reid v. Eatonton Mfg. Co.*, 40 Ga. 98, 2 Am. Rep. 563; *Mobile & O. R. Co. v. Tennessee*, 153 U. S. 486, 38 L. Ed. 793, 14 Sup. Ct. 968.

¹²³ Ante, § 114 et seq.

¹²⁴ *Loan Soc. of Philadelphia v. Eavenson*, 241 Pa. 65, 88 Atl. 295; *Fell v. Pitts*, 263 Pa. 314, 106 Atl.

to the corporation or to creditors, if they act in good faith and with due care, unless liability is imposed by some statute. In other words, they are not liable for mere errors of judgment.¹²⁵ In many jurisdictions, statutes have been enacted expressly making the directors or trustees of corporations liable to creditors, as well as the corporation, for paying dividends unlawfully, and thereby diminishing the capital stock. There is usually no liability under these statutes unless the directors act in bad faith or are guilty of negligence.¹²⁶

§ 163. Right to dividends between life tenant and remainderman.—When a person is entitled to the income and profits of shares of stock for life or for a term of years, under a will or gift, there is a conflict of opinion as to his right to dividends. The following summary may be given:

- (1) He is entitled to ordinary dividends declared after the testator's death, if declared out of profits earned since his death.
- (2) Some courts hold that he is entitled to dividends declared after the testator's death, though declared out of profits earned and accumulated by the corporation before his death; but the rule is otherwise in several states.
- (3) He is not entitled to dividends declared out of the capital, or funds representing capital.
- (4) He is not entitled to the right to subscribe for new shares on an increase of the capital stock, nor to the proceeds of a sale of such privilege.
- (5) Under the Massachusetts rule all stock dividends belong to the corpus and all cash dividends go to the life tenant.
- (6) The Pennsylvania rule apportions extraordinary dividends, cash or stock, between life tenant and remainderman according to whether the accumulation accrued before or after the creation of the life estate; if thereafter it is treated as income of the life tenant.

574; *Gratz v. Redd*, 4 B. Mon. (Ky.) 178; *Scott v. Eagle Fire Co.*, 7 Paige (N. Y.) 198; *Gaffney v. Colvill*, 6 Hill (N. Y.) 567; *In re National Funds Assur. Co.*, 10 Ch. Div. 118. Compare *In re National Bank of Wales*, [1899] 2 Ch. 629.

¹²⁵ *Lexington & O. R. Co. v. Bridges*, 7 B. Mon. (Ky.) 556, 46 Am. Dec. 528; *Excelsior Petroleum*

Co. v. Lacey, 63 N. Y. 422; *E. L. Moore & Co. v. Murchison*, 226 Fed. 679; *Davenport v. Lines*, 77 Conn. 473, 59 Atl. 603.

¹²⁶ *Excelsior Petroleum Co. v. Lacey*, 63 N. Y. 422; *Rorke v. Thomas*, 56 N. Y. 559; *Van Dyck v. McQuade*, 86 N. Y. 38; *United States Smelting Co. v. Hofkin*, 261 Fed. 546, *rev'd* on other grounds in 266 Fed. 679;

Where shares of stock are given by will or otherwise transferred in trust to pay the income and profits to one person for life or for a term of years, and the principal to another on termination of the life estate or term, or where a fund subject to such a trust is invested by the trustee in shares of stock, difficult questions arise as to the right to dividends on the shares as between the life tenant or tenant for years and the remainderman, or, in other words, as to what dividends constitute "income" or "profits," and go to the life beneficiary or tenant for years, and what constitute an addition to the principal, and go to the remainderman. On some of these questions the decisions are in direct conflict.

Dividends declared after testator's death.—Under a bequest or gift of the income and profits of shares of stock for life or years, the beneficiary is not entitled to dividends declared before, although not payable until after, the testator's death or the time of the gift. Such a dividend is a debt due from the corporation, and passes to the executor as a part of the estate.¹²⁷ As to all ordinary cash dividends declared after creation of the trust, there can be no doubt that they belong to the life tenant as income or profits, if they are declared out of profits earned by the corporation since the testator's death.¹²⁸

Some of the courts have gone farther than this, and have held that all cash dividends out of profits, declared after the testator's death, go to the life tenant, although they are payable out of profits earned by the corporation before his death, and although it may be not an ordinary dividend, but an extraordinary or unusual dividend, payable out of profits which had been allowed to accumulate for a number of years before the testator's death.¹²⁹

Williams v. Spensley, 251 Fed. 58; *White-Wilson-Drew Co. v. Lyon-Ratcliff Co.*, 268 Fed. 525. Cp. *Southern California Home Builders v. Young*, 45 Cal. App. 679, 691, 188 Pac. 586. See also, note, 35 Yale Law Journal 870, the statutory responsibility of directors for payment of dividends out of capital. See 3 Fletcher, Corporations, § 3744.

¹²⁷ *In re Kernochan*, 104 N. Y. 618, 11 N. E. 149.

¹²⁸ *In re McKeown's Estate*, 263 Pa. 78, 106 Atl. 189; *In re Earp's Appeal*, 28 Pa. St. 368; *In re Smith's Estate*, 140 Pa. St. 344, 21 Atl. 438, 23 Am. St. Rep. 237; *Van Doren v. Olden*, 19 N. J. Eq. 176, 97 Am. Dec.

650; *Davis v. Jackson*, 152 Mass. 58, 25 N. E. 21, 23 Am. St. Rep. 801; and other cases cited in the notes following.

¹²⁹ *Talbot v. Milliken*, 221 Mass. 367, 108 N. E. 1060; *Minot v. Paine*, 99 Mass. 101, 96 Am. Dec. 705; *Richardson v. Richardson*, 75 Me. 570, 46 Am. Rep. 428; *Millen v. Guerrard*, 67 Ga. 284, 44 Am. Rep. 720; *Clarkson v. Clarkson*, 18 Barb. (N. Y.) 646; *In re Kernochan*, 104 N. Y. 618, 11 N. E. 149; *Thomas v. Gregg*, 78 Md. 545; *McLouth v. Hunt*, 154 N. Y. 179, 48 N. E. 548, 39 L. R. A. 230, affirming 92 Hun (N. Y.) 607, 38 N. Y. Supp. 1146; *De Koven v. Alsop*, 205 Ill. 309, 68 N. E. 930, 63

Stock dividends.—By the so-called “Massachusetts rule” all stock dividends become a part of the *corpus* of the estate and belong to the remainderman. The idea is that the surplus has been capitalized and the interest represented by the stock is capital. All cash or property dividends paid upon stock dividends are payable to the owner of the life estate.¹³⁰ The Massachusetts rule awards to *corpus* (the remainderman) the entire extraordinary distribution or dividend from earnings if it is essentially a stock dividend, and to income (life beneficiaries) if essentially a cash dividend, without inquiring as to the time covered by the accumulation of earnings which it represents. But if a cash dividend represents a reduction of capital, or an enhancement of value of capital assets, it goes to *corpus*.¹³¹ In Massachusetts, for example, it is held that a stock dividend on shares, although it may be declared out of profits earned after the death of the testator, becomes a part of the *corpus* of the estate, to be preserved for the remainderman, and does not go to the life beneficiary as income or profits.¹³² This doctrine proceeds on the ground that since, in the absence of any restraining statute, a corporation may treat and deal with the money earned by it either as an increase of its property, or as the profits of its business, so long as the corporation holds it as part of the corporate property, it is capital of the corporation, and the interest therein represented by each share of stock is capital, and not income of that share.¹³³

Pennsylvania rule.—The Pennsylvania rule apportions an extraordinary dividend between the life tenant and the remainderman, according to whether it is declared out of profits earned before

L. R.-A. 587; *Lamb v. Lehmann*, 110 Ohio St. 59, 143 N. E. 276, 42 A. L. R. 437.

“This is sometimes known as the Massachusetts rule, and prevails in Massachusetts, Connecticut, Delaware, Georgia, Illinois, Kentucky, Maine, North Carolina and Vermont.” *Fletcher, Corporations*, sec. 3713. Also in Rhode Island and West Virginia.

Coolidge v. Grant, 251 Mass. 352, 146 N. E. 719 (cash dividends, however large, are regarded as income, and stock dividends, however made, as capital). See 34 Yale Law Journal, 195-199.

¹³⁰ *Talbot v. Milliken*, 221 Mass. 367, 108 N. E. 1060; *Gray v. Hemenway*, 212 Mass. 239, 98 N. E. 789; *Lamb v. Lehmann*, 110 Ohio St. 59,

143 N. E. 276, 42 A. L. R. 437; *Gibbons v. Mahon*, 136 U. S. 549, 34 L. Ed. 525, 10 Sup. Ct. 1057; *Union & New Haven Trust Co. v. Taintor*, 85 Conn. 452, 83 Atl. 697.

Apportionment of corporate earnings between life tenant and remainderman under a trust estate, see 33 Yale Law Journal 774.

¹³¹ 24 A. L. R. 42n; 42 A. L. R. 448 n.

¹³² *Minot v. Paine*, 99 Mass. 101, 96 Am. Dec. 705; *Rand v. Hubbell*, 115 Mass. 461, 15 Am. Rep. 121; *Davis v. Jackson*, 152 Mass. 58, 25 N. E. 21, 23 Am. St. Rep. 801.

¹³³ *Rand v. Hubbell*, 115 Mass. 461, 15 Am. Rep. 121; *Lamb v. Lehman*, 110 Ohio St. 59, 143 N. E. 276; 34 Yale Law Journal 195.

the testator's death or after the creation of the life estate. Under this rule the court inquires into the source and derivation of the fund from which the dividend is declared, and will award the life tenant that proportion of the dividend which has been earned during the life estate. This is apparently the majority American view.¹³⁴ In Pennsylvania, for example, it is held that the life tenant is entitled to all dividends declared out of profits earned after the testator's death, but not to dividends out of profits which accumulated during his lifetime.¹³⁵ If the fund accrued after the life estate arose, it is income and belongs to the tenant for life. The Pennsylvania rule, if it ascertains that the entire dividend was earned before the commencement of the life interest, awards the entire dividend, whether stock or cash, to the *corpus*; and if it ascertains that the entire dividend was earned during the continuance of the life interest, awards the entire dividend to income; and if it ascertains that the fund accumulated partly before and partly after the commencement of the life estate, undertakes to apportion the dividend, whether in stock or in cash, between the life tenant and the remainderman.¹³⁶ According to this doctrine, if a dividend is declared out of profits earned partly before and

¹³⁴ *In re Flaccus' Estate*, 283 Pa. 185, 129 Atl. 74, noted in 20 Ill. Law Rev. 316; 19 Ill. Law Rev. 476; *In re Waterman's Estate*, 279 Pa. 491, 124 Atl. 166; 14 C. J. 832; *In re Osborne*, 209 N. Y. 450, 103 N. E. 723, 50 L. R. A. (N. S.) 510, Ann. Cas. 1915 A 298; 68 Univ. Pennsylvania Law Rev. 85; 33 Yale Law Journal 774 (apportionment of corporate earnings between life tenant and remainderman); 34 Yale Law Journal 195 (apportionment of stock dividends); 39 Harvard Law Rev. 905; *In re Gartenlaub*, 185 Cal. 375, 197 Pac. 90, 24 A. L. R. 1, 9 n. (rights as between life beneficiaries and remaindermen in corporate dividends during the life interest); *In re Duffill's Estate*, 180 Cal. 748, 183 Pac. 337. See 42 A. L. R. 448, 451 n; 17 R. C. L. 630; 3 R. C. L. Supp. 716.

¹³⁵ *Smith's Estate*, 140 Pa. St. 344, 21 Atl. 438, 23 Am. St. Rep. 237; *In re Earp's Appeal*, 28 Pa. St. 368; *Wiltbank's Appeal*, 64 Pa. St. 256, 3 Am. Rep. 585; *In re Oliver's Estate*, 136 Pa. St. 43, 20 Atl. 527, 9 L. R. A. 421, 20 Am. St. Rep. 894.

¹³⁶ *In re Robert's Estate*, 117 Misc. Rep. 794, 191 N. Y. Supp. 527: Under the New York cases, the tests to be applied as to the apportionment of an extraordinary stock dividend between the life tenant and the remaindermen, are: (1) "The source of the property paid out in the form of an extraordinary dividend, and whether there has been a distribution or division of the earnings, profits or accumulations of the corporation; (2) the language of the will. *In re Osborne*, 209 N. Y. 450, 103 N. E. 723, 50 L. R. A. (N. S.) 510, Ann. Cas. 1915 A 298; *United States Trust Co. v. Heye*, 224 N. Y. 242, 255, 120 N. E. 645."

In re Heaton's Estate, 89 Vt. 550, 96 Atl. 21, L. R. A. 1916 D 201. A large stock dividend declared from accumulated surplus passed to life tenant and not remaindermen, under the rule that the life tenant receives all the profits of the corporation accumulated during the life of the trust, while the remainderman receives at the end of the term the corpus of the trust fund, undiminished in value.

partly after the testator's death, it is apportioned between the life tenant and the remainderman.¹³⁷ In the case of a stock dividend this rule gives to the *corpus* of the trust the number of new shares sufficient to preserve the intrinsic value of the capital calculated as of the commencement of the trust, unless there has been a decrease attributable to capital loss.

In all cases, of course, when a question arises as to whether certain dividends go to the life beneficiary of shares, the determination of the question depends primarily upon the intention of the testator or donor, and the intention, when once ascertained from the language of the will or other instrument, and the surrounding circumstances, must be given effect.¹³⁸

Dividends declared out of capital assets.—As a rule, dividends declared by a corporation out of its capital, or funds representing capital, as where it reduces its capitalization and sells a portion of the property or franchises in which its capital is invested, and distributes the proceeds, are not income or profits, and do not go to the life beneficiary, but are a part of the principal which must be preserved for the remainderman.¹³⁹ For example, if a city takes from a corporation, in the exercise of the power of eminent domain, property in which its capital has been invested, the money paid as compensation represents capital, and not profits, and if it is distributed by the corporation as a dividend, it does not go to a person who is entitled merely to the income and profits of shares.¹⁴⁰ And where a corporation ceases business and sells all its property, with a view to distribution among its stockholders, or when a corporation

¹³⁷ In re Earp's Appeal, 28 Pa. St. 368; 39 Harvard Law Rev. 905; 26 Harvard Law Rev. 77; 34 Yale Law Journal 195; 13 Michigan Law Rev. 242.

In McCracken v. Gulick, 92 N. J. Eq. 214, 112 Atl. 317, Swayze, J., said: "It is a fair inference that the testator meant the life tenant to have the ordinary annual income of those stocks. . . . The difficulty arises when the income is extraordinary, due to an unusual accumulation of earnings by reason of extraordinary prosperity, or when accumulated savings of years are to be distributed. Where the dividend is extraordinary we long ago adopted the rule of apportionment between the tenant for life and the remainderman."

¹³⁸ In re James, 146 N. Y. 78, 40 N. E. 876, 48 Am. St. Rep. 774.

¹³⁹ In re Vinton's Appeal, 99 Pa. St. 434, 44 Am. Rep. 116; Gifford v. Thompson, 115 Mass. 478; Heard v. Eldredge, 109 Mass. 258, 12 Am. Rep. 687; Wheeler v. Perry, 18 N. H. 307; Walker v. Walker, 68 N. H. 407, 39 Atl. 432; In re James, 78 Hun (N. Y.) 121, 28 N. Y. Supp. 992, aff'd 146 N. Y. 78, 40 N. E. 876, 48 Am. St. Rep. 774; United States Trust Co. v. Heye, 224 N. Y. 242, 120 N. E. 645; McCoy v. McCloskey, 94 N. J. Eq. 60, 117 Atl. 473. See 24 A. L. R. 92n; 42 A. L. R. 448, 458n.

¹⁴⁰ Heard v. Eldredge, 109 Mass. 258, 12 Am. Rep. 687.

is dissolved, and its assets so distributed, the dividend goes to the remainderman, and not to the life tenant of shares.¹⁴¹ This rule does not apply where the nature of a corporation is such that its ordinary business is to sell property in which its capital is invested, and distribute the proceeds among its stockholders. In a Massachusetts case, for example, it was held that a legatee entitled to the income for life from stock in a company deriving its profits from the improvement and sale of land was entitled to the ordinary dividends declared thereon, although they in reality consisted of a portion of the capital stock.¹⁴²

Proceeds of shares sold.—When a trust fund, the proceeds or income of which is to be paid to one person for life, with remainder to another, is invested in shares of stock, and the stock is sold, the proceeds of the sale are principal, and do not go to the life beneficiary, except in so far as they represent accumulated profits.¹⁴³

Dividends in bonds or certificates of indebtedness.—Dividends declared out of profits go to the person entitled to the income and profits of shares, although they are paid, not in cash, but in bonds of the company or certificates of indebtedness.¹⁴⁴

Stock rights, etc., and proceeds of sale thereof.—Where the capital stock of a corporation is increased under legislative authority, the privilege or right which the shareholders have to subscribe for the new shares is appurtenant to the original stock, and does

¹⁴¹ *In re Rogers*, 161 N. Y. 108, 55 N. E. 393; *Gifford v. Thompson*, 115 Mass. 478; *Wheeler v. Perry*, 18 N. H. 307.

Where a corporation, in whose stock a trust fund was invested, sold its assets and property, and voted to pay a dividend in cash to its stockholders on surrender of their certificates, the assets consisting at the time in part of capital and in part of undivided earnings, it was held that the entire amount received by the trustee was capital, and not income, and belonged to the remainderman, and not to the life beneficiary of the fund. *Gifford v. Thompson*, 115 Mass. 478. In such a case, however, according to the better opinion, there should be an apportionment, so much of the dividends as represents profits going to the life beneficiary and so much as represents

capital going to the remainderman. *Cobb v. Fant*, 36 S. C. 1, 14 S. E. 959; *In re Rogers*, 161 N. Y. 108, 55 N. E. 393, *aff'd* 22 N. Y. App. Div. 428, 48 N. Y. S. 175. Proceeds of liquidation of a corporation which represent profits earned during the term of the life tenant go to him. *In re Gerlach's Estate*, 177 Wis. 251, 188 N. W. 94.

¹⁴² *Reed v. Head*, 6 Allen (Mass.) 174; *Harvard College v. Armory*, 9 Pick. (Mass.) 446. See also, *In re James*, 146 N. Y. 78, 40 N. E. 876, 48 Am. St. Rep. 774; *In re Gartenlaub*, 185 Cal. 375, 197 Pac. 90, 24 A. L. R. 1, 102 n.

¹⁴³ *In re Kernochan*, 104 N. Y. 618, 11 N. E. 149. See 13 A. L. R. 1009n.

¹⁴⁴ *Millen v. Guerrard*, 67 Ga. 284, 44 Am. Rep. 720.

not belong to the person entitled to the income of the shares.¹⁴⁵ And, according to the weight of authority, if such right and privilege is sold by a trustee who holds shares on which a person is entitled to the income for life, the proceeds of the sale go, not to the life tenant, but to the remainderman.¹⁴⁶

Rights on death of life tenant.—Upon the death of a person entitled to the income and profits of shares of stock for life, his executor or administrator is clearly entitled to dividends declared during his lifetime.¹⁴⁷ It would seem equally clear that all dividends declared after his death, although declared out of profits earned by the corporation during his life, would go to the remainderman.¹⁴⁸ There are decisions, however, to the contrary, making the right of the life tenant's estate to undivided profits earned, though not declared as dividends depend on the intent of the testator rather than the action of the directors.¹⁴⁹

II. RIGHT TO INSPECT BOOKS AND PAPERS OF THE CORPORATION.

§ 164. In general.—At common law, a stockholder has a right to inspect and make abstracts or copies from the books and papers of the corporation, personally or by an agent, if the request to be allowed to do so is made at a reasonable time, and for a proper purpose. And he may enforce this right by mandamus, or in some states in equity by injunction, or maintain an action for damages against the officer denying him the right, or, in a proper case, against the corporation. In many states, this right is further secured and extended by express statutory provisions.

¹⁴⁵ *Hite's Devisees v. Hite's Ex'r*, 93 Ky. 257, 20 S. W. 778, 19 L. R. A. 173, 40 Am. St. Rep. 189; *In re Kernochan*, 104 N. Y. 618, 11 N. E. 149; *Thomson's Estate*, 153 Pa. St. 332, 26 Atl. 652, 653; *Girdwood v. Safe Deposit & Trust Co.*, 143 Md. 245, 122 Atl. 132, noted in 33 Yale Law Journal 774. See 18 Columbia Law Rev. 496; 24 A. L. R. 84 n; 42 A. L. R. 448 n; *Ballantine v. Young*, 79 N. J. Eq. 70, 81 Atl. 119 (the value of an option to take new stock goes to the corpus of the trust fund). *In re Dickinson*, 285 Pa. 449, 132 Atl. 352. See 24 A. L. R. 84 n; 42 A. L. R. 448, 458 n.

¹⁴⁶ *Atkins v. Albree*, 12 Allen (Mass.) 359; *Hite's Devisees v. Hite's Ex'r*, 93 Ky. 257, 19 L. R. A. 173, 40 Am. St. Rep. 189; *Brinley v. Grou*, 50 Conn. 66, 47 Am. Rep. 618; *In re Biddle's Appeal*, 99 Pa. St. 278; *In re Moss' Appeal*, 83 Pa. St. 264, 24 Am. St. Rep. 164; *Greene v. Smith*, 17 R. I. 28, 19 Atl. 1081; *Walker v. Walker*, 68 N. H. 407, 39 Atl. 432.

¹⁴⁷ Ante, § 160.

¹⁴⁸ Ante, § 160; *Mann v. Anderson*, 106 Ga. 818, 32 S. E. 870.

¹⁴⁹ *In re Sherman Trust*, 190 Iowa 1385, 179 N. W. 109.

At common law, every stockholder of a corporation has a right, by reason of his interest therein, to inspect and examine its books and papers, if he asserts the right at reasonable times, and for proper purposes germane to his interest as a stockholder; and he cannot lawfully be denied this right by the officers of the corporation or the other stockholders.¹⁵⁰

The claim of the stockholder to know how the affairs of the company are being conducted is founded on the necessity of self-protection. Managers of some corporations try to keep stockholders in ignorance or under misapprehension as to the condition of affairs. Business prudence demands that the investor be vigilant to watch whether the capital which he has risked in the enterprise is being profitably and honestly employed. Those in charge of this company might be guilty of gross incompetency or dishonesty for many years if the stockholders could not inspect the records and obtain information.¹⁵¹ The proper scope of the stockholder's right

150 *King v. Masters, etc., Merchant Tailors' Co.*, 109 Eng. Rep. 1086, 2 Barn. & Adol. 115; *Reg. v. Mariquita & New Granada Min. Co.*, 1 El. & El. 289, 120 Eng. Rep. 917; *Nelson v. Anglo-American Land Mortgage Agency Co.*, [1897] 1 Ch. 130; *Swift v. State*, 7 Houst. (Del.) 338, 6 Atl. 856, 40 Am. St. Rep. 127; *State v. Pacific Brewing & Malting Co.*, 21 Wash. 451, 58 Pac. 584, 47 L. R. A. 208; *Stone v. Kellogg*, 62 Ill. App. 444; aff'g 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Ellsworth v. Dorwart*, 95 Iowa 108, 63 N. W. 588, 58 Am. St. Rep. 427; *Legendre v. New Orleans Brewing Ass'n*, 45 La. Ann. 669, 40 Am. St. Rep. 243; *Huyler v. Cragin Cattle Co.*, 40 N. J. Eq. 392; *Feick v. Hill Bread Co.*, 91 N. J. Law 486, 103 Atl. 813; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 78 Am. St. Rep. 707; *Com. v. Phoenix Iron Co.*, 105 Pa. St. 111, 51 Am. Rep. 184; *Guthrie v. Harkness*, 199 U. S. 148, 50 L. Ed. 130, 26 Sup. Ct. 4, 4 Ann. Cas. 433; *In re Steinway*, 159 N. Y. 250, 53 N. E. 1103, 45 L. R. A. 461; *Charles Hegewald Co. v. State ex rel. Hegewald*, 196 Ind. 600, 149 N. E. 170, 43 A. L. R. 775. See elaborate note in 22 A. L. R. 25; 43 A. L. R. 783.

151 ". . . Many corporate reports fail to disclose full information and a requirement of publication of

uniform balance sheets and earnings statements would help materially in this respect. . . . Furthermore, there are many vital decisions of policy taken by the directors which would be revealed only to one having access to the corporate minute books. It is therefore suggested that machinery be created whereby representatives can be elected by the different groups of securityholders who will advise the securityholders, from time to time, as to the condition of the corporation, by way of check upon the management. In all corporations with more than a minimum number of securityholders, such advisory committees could be elected annually by the respective groups of securityholders." *Broader Legal Aspects of Customer Stock Ownership* by Eustace Seligman, of New York, N. Y., 50 Reports of American Bar Association (1925), 851, 853-854.

Under the Mexican Commercial Code a so-called "Vigilance Committee" may be elected at a general meeting of the shareholders. They may examine the books, minutes, correspondence, contracts and papers of the corporation. On the other hand, the individual shareholder in Mexico has no right of inspection at all. The directors submit to the Vigilance Committee yearly the general balance sheet for verification. Mexican Busi-

or privilege of inspection of the corporate files and records is a subject upon which there is much difference of opinion. Should the holder of a single share have the unrestricted right to inspect all the books, documents and records of the corporation? Must there be a showing of sufficient ground for the demand, and should there be something more than a mere bare suspicion of mismanagement? Inspection may be abused to divulge confidential information or to injure the corporation and the other stockholders for individual ends. The stockholders should be prevented, if possible, from causing a vexatious and burdensome interference with the business of the company, or giving information to those not fairly entitled to it. The court may require the right of inspection to be so exercised as not to aid in some improper scheme or design against the corporation or to betray its trade and business secrets.¹⁵²

A partner has the absolute right to inspect, at all times, all books and papers of the firm. The English courts took the view that the stockholder had the right only when there was a specific dispute about some corporate matter between the stockholder and the management. The American view in general is that if the stockholder applies in good faith to examine the books and records, he has the right enforceable by *mandamus*, but this right is conditioned or qualified if the corporation shows that the stockholder is acting from a hostile motive as a competitor or if there is an agreement in the articles of association against inspection.¹⁵³

Purposes of inspection.—By the English decisions, in the absence of a statute making the right of examination absolute, there must be something more than bare suspicion of mismanagement or fraud. There must be at least specific and reasonable grounds for

ness Corporations, De La Torre, 72 Univ. of Pennsylvania Law Rep. Supplement (1923).

¹⁵² 2 Machen, Corporations, secs. 1093, 1094; Cook, Corporations (8th Ed.), sec. 512. The rights of the corporation itself in the protection of its trade business secrets, and the interests of other stockholders are not to be disregarded. In re Wygant, 101 N. Y. Misc. 509, 167 N. Y. Supp. 369; Furst v. W. T. Rawleigh Medical Co., 282 Ill. 366, 118 N. E. 763. See 22 A. L. R. 89n; American Mortgage Co. v. Rosenbaum, 114 Ohio St. 231, 151 N. E. 122, noted, 12 Virginia Law Rev. 663 (if stock-

holder intends to use the information in a way to depreciate the assets of the company he is not entitled to a mandatory injunction); General Inv. Co. v. American Hide & Leather Co., 97 N. J. Eq. 214, 127 Atl. 529, 535: "I can conceive of no monster of the jungle, or the most vivid imagination, that could unsettle the nerves of a corporation director when engaged in rejuvenating an embarrassed company, as the appearance of Mr. Verner in search of information."

¹⁵³ Klotz v. Pan-American Match Co., 221 Mass. 38, 108 N. E. 764, Ann. Cas. 1917 D 895. The right is based on the stockholder's interest

suspicion. The right of a stockholder to examine the books and papers of the corporation is not unlimited, as is the right of a partner to examine the books and papers of the partnership. He can insist upon and enforce the right when he has a good and specific reason for making the examination, and where his purpose is a proper one, but not otherwise. He cannot do so from mere curiosity, or for merely speculative purposes, or for reasons not connected with his rights as a stockholder, or vexatiously, but, at common law at least, he can do so only when he asserts the right "in good faith, and for a specific, honest purpose, and where there is a particular matter in dispute involving and affecting seriously his rights as a stockholder."¹⁵⁴

By the general rule in the United States, stockholders have a right to inspect the books and papers of the corporation without first showing any particular dispute or mismanagement, where they wish to make the examination in good faith for the purpose of seeing whether its affairs are properly managed, or to ascertain the condition of the company's business.¹⁵⁵ In *Guthrie v. Harkness*,¹⁵⁶ there was involved the right of a stockholder in a national bank to inspect its books for the purpose of ascertaining whether the business affairs of the bank had been conducted according to law, and whether, as suspected, the bank was guilty of irregularities.

in the assets and business of the corporation. It is not absolute, but qualified for protection of the interests of the corporation and the other stockholders. See note in 20 L. R. A. (N. S.) 185; Ann. Cas. 1913 E 173; Ann. Cas. 1917 D 895.

¹⁵⁴ The English rule has been made broader by statute. *Bank of Bombay v. Suleman Somji*, 99 Law Times Rep. (N. S.) 62; *Davies v. Gas Co.*, [1909] 1 Ch. 708.

"There is no express rule that to warrant an application to inspect corporation documents there must actually have been a suit instituted; but it is necessary that there should be some particular matter in dispute, between members, or between the corporation and individuals in it; there must be some controversy, some specific purpose in respect of which the examination becomes necessary." *Rex v. Merchant Tailors' Co.*, 2 Barn. & Adol. 115.

Some American cases follow the former English rule. *Brunning v.*

Hoboken Prtg. & Pub. Co., 67 N. J. Law 119, 50 Atl. 906; *Charles Hegewald Co. v. State ex rel. Hegewald*, 196 Ind. 600, 149 N. E. 170, 43 A. L. R. 775. Mandamus to inspect corporate books not granted unless stockholder shows some specific purpose or beneficial purpose for which inspection of books is desired. Privilege must be sought in good faith for the protection of stockholder's interests in the corporation.

¹⁵⁵ *Huyilar v. Cragin Cattle Co.*, 40 N. J. Eq. 392, 2 Atl. 274; *State ex rel. Weinberg v. Pacific Brewing & Malting Co.*, 21 Wash. 451, 58 Pac. 584, 47 L. R. A. 208; *Varney v. Baker*, 194 Mass. 239, 80 N. E. 524, 10 Ann. Cas. 989; *Guthrie v. Harkness*, 199 U. S. 148, 50 L. Ed. 130, 26 Sup. Ct. 4, 4 Ann. Cas. 433; 25 Harvard Law Rev. 662; 12 Columbia Law Rev. 274.

¹⁵⁶ 199 U. S. 148, 50 L. Ed. 130, 26 Sup. Ct. 4, 4 Ann. Cas. 433; *Morgan v. Howard*, 293 Fed. 650.

The court said: "The decisive weight of American authority recognizes the right of the shareholder, for proper purposes and under reasonable regulations as to place and time, to inspect the books of the corporation of which he is a member. . . . In issuing the writ of mandamus the court will exercise a sound discretion and grant the right under proper safeguards to protect the interest of all concerned. The writ should not be granted for speculative purposes or to gratify idle curiosity or to aid a blackmailer, but it may not be denied to the stockholder who seeks the information for legitimate purposes."

Among the purposes for which inspection may be had are the following: To ascertain the financial condition or propriety of dividends, or the value of the stock and whether there had been mismanagement; in anticipation of corporate meetings where important questions are to be voted on; in aid of litigation with the corporation or its officers. At common law the purpose of the stockholder in seeking to enforce inspection must be a proper and reasonable one, and the interests which he seeks to protect must be incident to his rights as a stockholder.¹⁵⁷

The right of a director to inspect the books of the corporation is unqualified.¹⁵⁸ The duties of his position require him to be familiar with the affairs of the company. Inspection by a stockholder is primarily for the purpose of protecting his individual interests. Inspection by a director is with a view to enable him to perform his duties intelligently. But after dissolution the court

157 22 A. L. R. 61n; *Drovin v. Lehigh Coal & Navigation Co.*, 265 Pa. 447, 109 Atl. 128 (to enable plaintiff to consult with his fellow stockholders and obtain proxies to be used at an approaching election of directors is proper purpose); *Otis-Hidden Co. v. Scheirich*, 187 Ky. 423, 219 S. W. 191, 22 A. L. R. 19 (right to inspect, the sole object information as to manner in which business is conducted; correspondence relating to management).

Some courts will not deny mandamus although the purpose of the stockholder is to obtain a list of the stockholders to use in his private business as a broker, thus not relating to his interests as a stockholder. *White v. Manter*, 109 Me. 408, 84 Atl. 890, 42 A. L. R. (N. S.) 332; *Shea v. Parker*, 234 Mass. 592, 126 N. E. 47; *State ex rel. Costello v. Middlesex*

Banking Co., 87 Conn. 483, 88 Atl. 861; *Murray v. Walker*, 156 Ky. 536, 161 S. W. 512, Ann. Cas. 1915 C 363.

That mandamus will not issue to secure business "prospects" or investment or advertising lists, see *State ex rel. Theile v. Cities Service Co.*, 1 W. W. H. (31 Del.) 346, 114 Atl. 463; *Aulthouse v. Giroux Consol. Min. Co.*, 122 N. Y. App. Div. 617, 107 N. Y. Supp. 188; *Day & Co. v. Booth*, 123 Me. 443, 123 Atl. 557, 43 A. L. R. 780, 783 n, stockholder's right to inspect books and records of corporation.

158 *Machen v. Machen & Mayer Electrical Mfg. Co.*, 237 Pa. 212, 85 Atl. 100, 42 L. R. A. (N. S.) 1079, Ann. Cas. 1914 B 420; *State ex rel. Aultman v. Ice*, 75 W. Va. 476, 84 S. E. 181, L. R. A. 1915 D 288. See 22 A. L. R. 59; *Cook, Corporations* (8th Ed.), sec. 511.

will exercise discretion in granting director's permission to inspect the books.¹⁵⁹

A corporation cannot by a by-law provide that the directors shall determine from time to time whether, when and under what conditions the accounts and books of the corporation shall be open to the inspection of the stockholders. Such a by-law is invalid, and cannot deprive the stockholder of his legal rights or the courts of the power to enforce them.¹⁶⁰

In most jurisdictions, the right of stockholders to inspect and examine the books and papers of the corporation is not left to be determined by the common law, but is regulated by statutes or by the constitution. Sometimes the right is given in express terms by the charter or articles of association of a corporation, or regulated by its by-laws. The aim of statutes regulating the right of inspection is generally to enlarge and extend the right as it existed at common law, and to enable the stockholder fully to inform himself in reference to the affairs of the company in which he has invested his money and of which he is one of the co-owners.¹⁶¹

Under a general statute providing that the stockholders of all private corporations shall "have the right of access to, inspection and examination of the books, records and papers of the corporation, at reasonable and proper times," it is to be implied that the inspection and examination shall not be from mere idle curiosity, or for speculative purposes, or for purposes hostile to the interests of the corporation, and by the express provisions of the statute the right must be asserted at "reasonable and proper times"; but these are the only limitations upon the right. It is not necessary to show any particular reason or occasion for making the inspection and examination.¹⁶²

¹⁵⁹ *People ex rel. Bellman v. Standard Match Co.*, 208 N. Y. App. Div. 4, 202 N. Y. Supp. 840, 24 Columbia Law Rev. 799 n.

¹⁶⁰ *Klotz v. Pan-American Match Co.*, 221 Mass. 38, 108 N. E. 764, Ann. Cas. 1917 D 895; *Commonwealth ex rel. Wilde v. Pennsylvania Silk Co.*, 267 Pa. 331, 110 Atl. 157. By-laws may provide for inspection, *State ex rel. Gwinn v. Bucklin*, 83 Wash. 23, 145 Pac. 58, L. R. A. 1915 D 285.

¹⁶¹ *Venner v. Chicago City R. Co.*, 246 Ill. 170, 92 N. E. 643, 138 Am. St. Rep. 229, 20 Ann. Cas. 607; note 7 Illinois Law Rev. 155; *Hauser v. York Water Co.*, 278 Pa. 387, 123 Atl.

330. Purpose of stockholder in petitioning for inspection to take list of stockholders is immaterial. Stockholders are entitled to a list of all the corporation's stockholders without discussion with the board of directors.

¹⁶² *Foster v. White*, 86 Ala. 467, 6 So. 88; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707; *State ex rel. Bergenthal v. Bergenthal*, 72 Wis. 314, 39 N. W. 566; *Ellsworth v. Dorwart*, 95 Iowa 108, 63 N. W. 588, 58 Am. St. Rep.

When a stockholder has sufficient reason for making an examination of the books or papers of the corporation, he need not necessarily do so in person, but may do so through his attorney, or an expert accountant, or other agent.¹⁶³ But the court may exercise some control to prevent the stockholder from designating an attorney or agent who is hostile to the corporation or is seeking to compel the corporation to buy the stock of his client in order to avoid a laborious investigation, and embarrassment and expense.¹⁶⁴ The stockholder has the incidental right to make abstracts, memoranda and copies.¹⁶⁵

In *Hobbs v. Tom Reed Gold Min. Co.*,¹⁶⁶ the California court declared that "it would, indeed, be a strange rule which would allow the stockholder to examine the books of a corporation to ascertain its condition and deny him an inspection of the property to verify the statements contained in its books. The rule at common law, in our opinion, extends to the corporate property as fully as to the books."

§ 165. Remedies of stockholders on denial of right.

If the officers of a corporation wrongfully deny a stockholder the right to inspect its books or papers, he may enforce his right

427; *Venner v. Chicago City R. Co.*, 246 Ill. 170, 92 N. E. 643, 138 Am. St. Rep. 229, 20 Ann. Cas. 607.

Under some statutes the stockholder must still prove a proper motive and reasonable ground to inspect (*O'Hara v. National Biscuit Co.*, 69 N. J. Law 198, 54 Atl. 241). Under other statutes, apparently absolute in terms, hostile or ulterior motives may be shown by the corporation in defense. *Foster v. White*, 86 Ala. 467, 6 So. 88; *Knox v. Coburn*, 117 Me. 409, 105 Atl. 789; *Schroek v. J. M. Quinby & Co.*, — N. J. Law —, 134 Atl. 92, noted in 25 Michigan Law Rev. 71.

¹⁶³ *Foster v. White*, 86 Ala. 467, 6 So. 88; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707; *State v. Bienville Oil Works Co.*, 28 La. Ann. 204; *Ellsworth v. Dorwart*, 95 Iowa 108, 63 N. W. 588, 58 Am. St. Rep. 427.

¹⁶⁴ *Lien v. Savings, Loan & Trust Co.*, 43 N. D. 260, 174 N. W. 621; *State ex rel. Humphrey v. Monida &*

Yellowstone Stage Co., 110 Minn. 193, 124 N. W. 971, 125 N. W. 676. See 22 A. L. R. 93.

¹⁶⁵ *Swift v. State*, 7 Houst. (Del.) 338, 6 Atl. 856, 32 Atl. 143, 40 Am. St. Rep. 127; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707; *Nelson v. Anglo-American Land Mortgage Agency Co.*, [1897] 1 Ch. 130; *Shea v. Parker*, 234 Mass. 592, 126 N. E. 47. See 22 A. L. R. 94.

¹⁶⁶ 164 Cal. 497, 129 Pac. 781, 43 L. R. A. (N. S.) 1112, noted in 1 California Law Rev. 268. The court held that mandamus would issue, under the California statute, to compel the directors to make an order in California to persons in charge of the mine in Arizona, to permit plaintiff to visit, inspect and examine the mine there, accompanied by a mining engineer. See *Symmes v. Sierra Nevada Min. Co.*, 171 Cal. 427, 153 Pac. 710, noted in 4 California Law Rev. 239.

by writ of *mandamus*, unless this remedy is excluded by statute.¹⁶⁷ There is a conflict of authority whether, if the statute makes the right of inspection absolute, this takes away the discretion of the court to refuse to issue the writ if it is sought for an improper purpose. The trend of the later decisions seems to favor the exercise of a sound discretion to withhold the writ to protect the just interests of the corporation against abuse.¹⁶⁸ In a North Dakota case¹⁶⁹ the plaintiff as holder of 26 shares in a savings and trust company demanded an inspection of corporate records and books in an attempt to force a purchase of his stock by the defendant's president. Upon the refusal of the president to buy the stock, plaintiff's attorney threatened to occasion expense and trouble by an examination of all the records, books and assets. It was held that the plaintiff could not by *mandamus* compel the corporation to submit to his statutory right of inspection, where an improper purpose was shown.

According to some courts, if the corporation or the custodian of its books can show that the stockholder is seeking to inspect the books from idle curiosity or for an improper or hostile purpose, such showing will constitute sufficient ground for refusal to enforce the right of inspection by *mandamus*, although the statute provides that the stock ledger shall be open to inspection by the stockholders at all times.¹⁷⁰ It has been urged that if the officers and directors

¹⁶⁷ *Rex v. Merchant Tailors' Co.*, 2 Barn. & Adol. 115; *In re Steinway*, 159 N. Y. 250, 53 N. E. 1103, 45 L. R. A. 461; *Klotz v. Pan-American Match Co.*, 221 Mass. 38, 108 N. E. 764, Ann. Cas. 1917 D 895; *Swift v. State*, 7 Houst. (Del.) 338, 6 Atl. 856, 32 Atl. 143, 40 Am. St. Rep. 127; *Richardson v. Swift*, 7 Houst. (Del.) 137, 30 Atl. 781; *Stone v. Kellogg*, 62 Ill. App. 444, s. c., 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Commonwealth v. Phoenix Iron Co.*, 105 Pa. St. 111, 51 Am. Rep. 184; *State ex rel. Weinberg v. Pacific Brewing & Malting Co.*, 21 Wash. 451, 58 Pac. 584, 47 L. R. A. 208. *Contra*, under the Ohio statute, *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707.

¹⁶⁸ *In re De Vengoechea*, 86 N. J. Law 35, 91 Atl. 314; *mandamus* denied on ground of ulterior hostile motive of applicant. See *Day & Co. v. Booth*, 123 Me. 443, 123 Atl. 557, 43

A. L. R. 780, 783, 786 n; *State ex rel. Theile v. Cities Service Co.*, 1 W. W. H. (31 Del.) 514, 115 Atl. 773, 22 A. L. R. 8; *People ex rel. Britton v. American Press Ass'n*, 148 N. Y. App. Div. 651, 133 N. Y. Supp. 216; *Shea v. Sweetser*, 119 Me. 400, 111 Atl. 579; *Lien v. Savings, Loan & Trust Co.*, 43 N. D. 260, 174 N. W. 621. See also, 22 A. L. R. 43 n, 43 A. L. R. 783; 22 Columbia Law Rev. 274 (statutes should preserve discretionary power of the courts).

¹⁶⁹ *Lien v. Savings, Loan & Trust Co.*, 43 N. D. 260, 174 N. W. 621; note, 4 Minnesota Law Rev. 296.

¹⁷⁰ *State ex rel. Theile v. Cities Service Co.*, 1 W. W. H. (31 Del.) 514, 115 Atl. 773, 22 A. L. R. 8. *Cp. Furst v. W. T. Rawleigh Medical Co.*, 282 Ill. 366, 118 N. E. 763; *Shea v. Sweetser*, 119 Me. 400, 111 Atl. 579; *Bernert v. Multnomah Lumber & Box Co.*, — Ore. —, 247 Pac. 155 (burden is on corporation to prove that inspection was desired for

may refuse to permit the stockholder to exercise the right of inspection which the statute grants on the ground that his motives are improper, then the right granted by the statute will oftentimes be defeated. The burden of litigating this question may be sufficient to deter the stockholder from attempting to enforce his right. Some courts accordingly hold that the motive of the petitioning stockholder will not be inquired into on petition for *mandamus*.¹⁷¹

The right of a stockholder of a foreign corporation to inspect its books may be enforced in any state where the corporation has a place of business and the books and their custodian may be found. This is not an interference with the internal affairs of the foreign corporation.¹⁷² A writ of *mandamus* may issue to enforce the right of a nonresident stockholder to inspect and take copies of documents of a foreign corporation, if they are in the custody of an agent within the state.¹⁷³ And the court may compel a domestic corporation to bring its books and papers into the state for an inspection, where they are kept in another state.¹⁷⁴

Stockholders have generally enforced their right to inspect the books and papers of the corporation by *mandamus*, and there are very few reported cases in which it has been sought to enforce the right in equity by injunction. It has been held, however, in some jurisdictions, that under statutory provisions, a suit for an injunction will lie.¹⁷⁵ Of course, a court of equity has jurisdiction to

wrongful purpose to defeat *mandamus* petition).

¹⁷¹ The following cases hold that if the statutory right of inspection is absolute, the courts cannot inquire into the motives of stockholders who demand inspection by the only adequate remedy. *Johnson v. Langdon*, 135 Cal. 624, 67 Pac. 1050, 87 Am. St. Rep. 156; *Venner v. Chicago City Ry. Co.*, 246 Ill. 170, 92 N. E. 643, 138 Am. St. Rep. 229, 30 Ann. Cas. 607; *Weihenmayer v. Bitner*, 88 Md. 325, 42 Atl. 245, 45 L. R. A. 446n; *State ex rel. Dempsey v. Werra Aluminum Foundry Co.*, 173 Wis. 651, 182 N. W. 354, 22 A. L. R. 1. Right of inspection of books by Wisconsin statutory provision is absolute and courts will not refuse *mandamus* on account of motives of stockholders who demand inspection. Courts should not deny the only effective remedy, as this emasculates the statute.

¹⁷² *Andrews v. Mines Corp.*, 205

Mass. 121, 91 N. E. 122, 137 Am. St. Rep. 428; *Machen v. Machen & Mayer Electrical Mfg. Co.*, 237 Pa. 212, 85 Atl. 100, 42 L. R. A. (N. S.) 1079, Ann. Cas. 1914 B 420. *Contra*, *In re Rappleye*, 43 N. Y. App. Div. 84, 59 N. Y. Supp. 338.

¹⁷³ *Richardson v. Swift*, 7 Houst. (Del.) 137, 30 Atl. 781; *Swift v. State*, 7 Houst. (Del.) 338, 6 Atl. 856, 32 Atl. 143, 40 Am. St. Rep. 127; *Andrews v. Mines Corp.*, 205 Mass. 121, 91 N. E. 122, 137 Am. St. Rep. 428.

¹⁷⁴ *Huyler v. Cragin Cattle Co.*, 40 N. J. Eq. 392, 2 Atl. 274; *Mitchell v. Rubber Reclaiming Co.* (N. J. Eq.), 24 Atl. 407. Compare *Huyler v. Cragin Cattle Co.*, 42 N. J. Eq. 139, 7 Atl. 521.

¹⁷⁵ *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707; *Ranger v. Champion Cotton-Press Co.*, 51 Fed. 61; *Nelson v. Anglo-American Land Mortgage*

enforce the right of inspection, if the circumstances are such that *mandamus* will not afford an adequate remedy, or if there are other grounds of equitable jurisdiction.¹⁷⁶

If an officer of a corporation, having the custody of its books and papers, wrongfully refuses to allow a stockholder to inspect the same, he is guilty of a wrong against the stockholder, and is liable in an action for damages.¹⁷⁷ The corporation itself will be liable in damages for denial of a stockholder's right to inspect books and papers, if it can be regarded as in default in the matter, as where the inspection is refused by order of the board of directors or the majority stockholders as a body. It has been held, however, that a stockholder cannot hold his co-stockholders or the corporation liable in damages on account of the refusal by a subordinate officer of an informal request to be allowed to inspect books or papers of the corporation, although he would have ascertained that the affairs of the corporation were being improperly managed, and might have taken steps to avoid loss. Upon such a refusal, he should apply for a writ of *mandamus*, or else apply to the directors, so as to put the company in default.¹⁷⁸

When the right of a stockholder to inspect the books and papers of the corporation is regulated by statute, a specific penalty is sometimes imposed upon the corporation, or upon the officer denying him the right, to be recovered in an action by the stockholder or by the state. And the penalty may be recovered without showing any actual pecuniary damage. All that is necessary is to show a wrongful denial of the right.¹⁷⁹

Agency Co., [1897] 1 Ch. 130. But see *Fuller v. Alexander Hollander & Co.*, 61 N. J. Eq. 648, 47 Atl. 646, 88 Am. St. Rep. 456; *Shea v. Parker*, 234 Mass. 592, 126 N. E. 47; *Otis-Hidden Co. v. Scheirich*, 187 Ky. 423, 219 S. W. 191, 22 A. L. R. 19.

¹⁷⁶ *Huyler v. Cragin Cattle Co.*, 40 N. J. Eq. 392, 2 Atl. 274; *Ranger v. Champion Cotton-Press Co.*, 51 Fed. 61. See *Harden v. Eastern States Public Service Co.*, 14 Del. Ch. 156, 122 Atl. 705. The legal remedy by *mandamus* is adequate, although the denial in the return to the alternative writ of any one of the essential averments in the stockholder's petition results in defeating the remedy. So *mandamus* if peremptorily issued is adequate.

¹⁷⁷ *Legendre v. New Orleans Brew-*

ing Ass'n, 45 La. Ann. 669, 12 So. 837, 40 Am. St. Rep. 243.

¹⁷⁸ *Legendre v. New Orleans Brewing Ass'n*, 45 La. Ann. 669, 12 So. 837, 40 Am. St. Rep. 243. See *Fuller v. Alexander Hollander & Co.*, 61 N. J. Eq. 648, 47 Atl. 646, 88 Am. St. Rep. 456; *Boardman v. Marshalltown Grocery Co.*, 105 Iowa 445, 75 N. W. 343.

¹⁷⁹ *Kelsey v. Pfaudler Process Fermentation Co.*, 51 Hun (N. Y.) 636, 3 N. Y. Supp. 723; *Henry v. Babcock & Wilcox Co.*, 196 N. Y. 302, 89 N. E. 476, 24 L. R. A. (N. S.) 967 ("He must be a stockholder and he must prefer his request during business hours. That is all."); *People v. Bowie*, 166 N. Y. Supp. 905 (refusal to allow inspection is made misdemeanor if act is "wilful"). See,

The true situation of a company is often concealed for the benefit of insiders by understatement as well as overstatement of surplus, earnings, depreciation, etc. In a vigorous contention for adequate corporate publicity by publication of informative balance sheets and income accounts, Professor Ripley urges the introduction of a stockholders' audit and general check-up committee, at the expense of the corporation, but under the supervision of the shareholders, as under the British Company Acts and also in Germany.¹⁸⁰

as to the liability to a penalty, *Lewis v. Brainerd*, 53 Vt. 519.

¹⁸⁰ "Stop, Look, Listen." The shareholder's right to adequate information, W. Z. Ripley, 138 *Atlantic Monthly*, p. 380 (Sept. 1926).

English Companies Act, § 26; Dominion (Canadian) Companies Act, § 106; Ohio General Corporation Act, § 64; Publicity of accounts and directors' purchase of stock, Berle, 25 *Michigan Law Rev.* 827, 836.

CHAPTER XV.

VOTING RIGHTS AND POWERS OF STOCKHOLDERS.

I. CORPORATE MEETINGS AND ELECTIONS.

§ 166. In general.—As a general rule, the stockholders or members of a corporation cannot act for the corporation, so as to bind it, except at a meeting legally called and conducted.

In regard to corporate meetings, the following general rules apply:

- (1) The meeting must be called by the authority and in the mode, if any, prescribed by the charter or by-laws, in so far as the provisions are not merely directory.
- (2) Notice of a meeting is not necessary, unless expressly required, if the time and place is fixed by the charter, by-laws, or usage; but if not so fixed, notice to every stockholder is necessary, both of the time and place, and, if a special meeting, of the business to be transacted.
- (3) Meetings are to be held at the time and place, if any, fixed by the charter or by-laws, or, in the absence of any provision, at a reasonable time and place. As a rule, a meeting of stockholders cannot be legally held beyond the limits of the state by which the corporation was created; but proceedings at such a meeting may be sustained by application of the doctrine of estoppel.
- (4) A corporate meeting, in order that the action thereat may be legal, must be conducted fairly and in accordance with mandatory charter or statutory provisions.
- (5) In the absence of provision to the contrary, any number of stockholders who may attend, if there are more than one, and if notice, when necessary, has been given, constitute a quorum, and may transact business, and a majority of the votes cast will decide.

- (6) In the absence of proof to the contrary, it will be presumed that a meeting was legally called, that proper notice was given, that it was held at a proper time and place, that a quorum was present, and that it was in all respects legally conducted.

The corporate powers, so far as they are vested in the stockholders or members, are vested in them collectively, as a body, and not as individuals. They have no power to act as or for the corporation except at a corporate meeting called and conducted according to law. Action by the stockholders or members individually, and not at a corporate meeting, even though a majority may concur, and even though their consent be expressed in a writing signed by them, is not the action of the corporation, and is void.¹ Thus, a majority of the stockholders of a corporation cannot appoint an agent for the corporation, or authorize the execution of a corporate contract, deed, or mortgage, where they express their assent, not in a meeting of stockholders, but separately and at different times.² Individual assents, however, given by stockholders separately and elsewhere than at a corporate meeting, may preclude those who so assent from complaining of what they have sanctioned.³ Where all the stockholders of a company are present at a meeting, there is no necessity for any further formality, and the company will be bound by the unanimous agreement of its members.⁴

¹ De La Vergne Refrigerating Mach. Co. v. German Sav. Institution, 175 U. S. 40, 44 L. Ed. 65, 20 Sup. Ct. 20; Peirce v. New Orleans Bldg. Co., 9 La. 397, 29 Am. Dec. 448; Dennis v. Joslin Mfg. Co., 19 R. I. 666, 36 Atl. 129, 61 Am. St. Rep. 805; Com. v. Cullen, 13 Pa. St. 133, 53 Am. Dec. 450; Duke v. Markham, 105 N. C. 131, 10 S. E. 1017, 18 Am. St. Rep. 889; Finley Shoe & Leather Co. v. Kurtz, 34 Mich. 89; Lawrence v. Montgomery Gas Co., 88 W. Va. 352, 106 S. E. 890; In re George Newman & Co., [1895] 1 Ch. 674. See post, § 176; ante, § 100; 3 Fletcher, Corporations, sec. 1630.

Parol evidence of the resolutions and proceedings may be heard to show what was done if the minutes are incomplete, indefinite or fragmentary; otherwise if the minutes are complete. *Respass v. Rex Spinning Co.*, 191 N. C. 809, 133 S. E. 391; 4 Fletcher, Corporations, sec. 2782.

² Peirce v. New Orleans Bldg. Co., 9 La. 397, 29 Am. Dec. 448; Duke v. Markham, 105 N. C. 131, 10 S. E. 1017, 18 Am. St. Rep. 889. See In re Wm. S. Butler & Co., Inc., 207 Fed. 705.

³ In re George Newman & Co., [1895] 1 Ch. 674; Strickland v. Jolly, 136 Ga. 835, 72 S. E. 348 (unanimous consent).

⁴ In re Express Engineering Works, Ltd., [1920] 1 Ch. 466, 10 Brit. Rul. Cas. 629, 634, it is competent for all the stockholders acting together to waive all formalities as regards notices of meetings, etc., and to resolve themselves into a meeting of shareholders and unanimously pass a resolution binding the corporation, at least as to matters not *ultra vires*. A company is bound by the unanimous action of all the stockholders, even though taken at a meeting called a directors' meeting. See *Gerard v. Empire Square Realty Co.*, 195 N. Y. App. Div. 244, 187 N. Y. Supp. 306.

§ 167. Calling of corporate meetings and notice.

When the charter or by-laws of a corporation require corporate meetings to be called by a particular authority, or in a particular mode, and the provisions are mandatory, the requirements must be complied with to render the meeting legal.⁵ In the absence of express provision in the charter or by-laws, meetings may be called by the board of directors whenever they deem it necessary to do so,⁶ or by an officer or general agent who is intrusted with the management of the corporation.⁷ Irregularities in calling a meeting, or failure to comply with the requirements of the charter or by-laws, will not render a meeting illegal, if all the persons who are entitled to vote are present, or if they subsequently ratify the action taken.⁸

Where the charter or by-laws of a corporation fix the time and place at which regular meetings shall be held, or they are fixed by usage, this is itself sufficient notice to stockholders or members, and no further notice is necessary.⁹ But if the time and place is not so fixed, as where a special meeting is called, notice must be given to every stockholder or member who is entitled to vote.¹⁰ Notice is necessary, of course, when required by the charter or by-laws of the corporation, and it must be given in the mode and form, and for

⁵ *Evans v. Osgood*, 13 Me. 213; *Congregational Society of Bethany v. Sperry*, 10 Conn. 200; *State v. Pettinelli*, 10 Nev. 141; *Matthews v. Columbia Nat. Bank*, 9 Fed. 558; *Stevens v. Eden Meeting House Society*, 12 Vt. 688; *Smith v. Dorn*, 96 Cal. 73, 30 Pac. 1024; *Whipple v. Christi*, 122 Minn. 73, 141 N. W. 1107, Ann. Cas. 1914 D 856; *Grant v. Elder*, 64 Col. 104, 170 Pac. 198.

⁶ *Commonwealth v. Smith*, 45 Pa. St. 59; *Walsh v. State ex rel. Cook*, 199 Ala. 123, 74 So. 45, 2 A. L. R. 551. They must act as a board. *Johnston v. Jones*, 23 N. J. Eq. 216.

⁷ *Stebbins v. Merritt*, 10 Cush. (Mass.) 27. See *Grant v. Elder*, 64 Colo. 104, 170 Pac. 198.

⁸ *William Firth Co. v. South Carolina Loan & Trust Co.*, 122 Fed. 569; *Guaranty Loan Co. v. Fontanel*, 183 Cal. 1, 190 Pac. 177; *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454; *Weinburg v. Union Street-Railway Advertising Co.*, 55 N. J. Eq. 640, 37 Atl. 1026.

Unreasonable delay in objecting may be equivalent to ratification. *Southern Counties Deposit Bank v. Rider*, 73 Law T. (N. S.) 374; *Weinburg v. Union Street Railway Advertising Co.*, 55 N. J. Eq. 640, 37 Atl. 1026.

⁹ *Morrill v. Little Falls Mfg. Co.*, 53 Minn. 371, 55 N. W. 547, 21 L. R. A. 174; *Warner v. Mower*, 11 Vt. 385; *People v. Batchelor*, 22 N. Y. 128; *State v. Bonnell*, 35 Ohio St. 10. But see *Dolbear v. Wilkinson*, 172 Cal. 366, 156 Pac. 488, Ann. Cas. 1917 E 1001; *People ex rel. Carus v. Matthiessen*, 269 Ill. 499, 109 N. E. 1056, Ann. Cas. 1916 E 1035.

¹⁰ *Stow v. Wyse*, 7 Conn. 214, 18 Am. Dec. 99; *People v. Batchelor*, 22 N. Y. 128; *San Buenaventura Commercial Min. & Mfg. Co. v. Vassault*, 50 Cal. 534; *Wiggin v. First Freewill Baptist Church*, 8 Mete. (Mass.) 301; *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454; *Asbury v. Mauney*, 173 N. C. 454, 92 S. E. 267.

the time, if any, therein prescribed,¹¹ and it must specify the time and place of holding the meeting, and be given a reasonable time before the meeting, except in so far as this is fixed by the charter or by-laws.¹² In the case of special meetings, the notice must state the business to be transacted, and no other business than that stated can be transacted,¹³ but, as a rule, it is otherwise in the case of a general meeting, which is for the transaction of all business incident to the corporate powers and interests; and, in the absence of provision to the contrary, all stated meetings are general.¹⁴

Notice of a corporate meeting may be waived; and therefore, if all the stockholders or members who are entitled to vote are present, the validity of a meeting is not affected by failure to give notice, or by defects or irregularities in giving notice.¹⁵ A stockholder who is present and participates, without objection, in a meeting, cannot afterwards complain of failure to give notice, or defects therein, either to himself or to other stockholders.¹⁶

¹¹ *Dolbear v. Wilkinson*, 172 Cal. 366, 156 Pac. 488, Ann. Cas. 1917 E 1001; *Swansea Dock Co. v. Levien*, 20 L. J. Exch. 447; *Shelby R. Co. v. Louisville, Cincinnati & L. R. Co.*, 12 Bush. (Ky.) 62; *Stow v. Wyse*, 7 Conn. 214, 18 Am. Dec. 99; *Westcott v. Minnesota Min. Co.*, 23 Mich. 145; *Stevens v. Eden Meeting House Society*, 12 Vt. 688.

¹² *In re Election of Directors of Long Island R. Co.*, 19 Wend. (N. Y.) 37, 32 Am. Dec. 429; *San Buenaventura Commercial Min. & Mfg. Co. v. Vassault*, 50 Cal. 534 (holding that the hour must be specified); *State v. Bonnell*, 35 Ohio St. 10; *Miller v. English*, 21 N. J. Law 317.

¹³ *Gervasi v. Societa Giusippi Garibaldi De Mutuo Succorso*, 96 Conn. 50, 112 Atl. 693; *Warner v. Mower*, 11 Vt. 385; *Logie v. Mother Lode Copper Mines Co.*, 106 Wash. 208, 179 Pac. 835; *People's Mutual Ins. Co. v. Westcott*, 14 Gray (Mass.) 440; *Evans v. Boston Heating Co.*, 157 Mass. 37, 31 N. E. 698; *Mutual Fire Ins. Co. v. Farquhar*, 86 Md. 668, 39 Atl. 527; *Tiessen v. Henderson*, [1899] 1 Ch. 861.

¹⁴ *Warner v. Mower*, 11 Vt. 385; *Atlantic De Laine Co. v. Mason*, 5 R. I. 463.

But notice of unusual or extraordinary business to be transacted at a general meeting, as an increase of stock, for example, may be expressly

required by the statute, charter, or by-laws; and even when not so required, it has been held to be necessary. *People's Mut. Ins. Co. v. Westcott*, 14 Gray (Mass.) 440; *Jones v. Concord & M. R. Co.*, 67 N. H. 119, 234, 30 Atl. 614, 68 Am. St. Rep. 650; *Mutual Fire Ins. Co. v. Farquhar*, 86 Md. 668, 39 Atl. 527; *Bagley v. Reno Oil Co.*, 201 Pa. 78, 50 Atl. 760, 56 L. R. A. 184.

¹⁵ *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; *In re British Sugar Refining Co.*, 26 Law J. Ch. 369, 3 Kay & J. 408; *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454; *Kenton Furnace R. & Mfg. Co. v. McAlpin*, 5 Fed. 737; *Scranton Axle & Spring Co. v. Scranton Board of Trade*, 271 Pa. 6, 113 Atl. 838. See *Barnett v. Joseph Mayer & Bros.*, 119 Wash. 323, 205 Pac. 396 (if all present, it may be a meeting if so intended).

¹⁶ *Gervasi v. Societa Giusippi Garibaldi De Mutuo Succorso*, 96 Conn. 50, 112 Atl. 693; *Nickum v. Burckhardt*, 30 Ore. 464, 47 Pac. 474, 60 Am. St. Rep. 822; *Bucksport & Bangor R. Co. v. Buck*, 68 Me. 81; *Weinburg v. Union Street Railway Advertising Co.*, 55 N. J. Eq. 640, 37 Atl. 1026.

A stockholder who was represented at the meeting by proxy cannot complain. *Zabriskie v. Cleveland, C. & C. R. Co.*, 23 How. (U. S.) 381, 16

§ 168. Time and place of holding meetings and elections.

In the absence of express provision to the contrary, corporate meetings may be held at any reasonable time.¹⁷ But the time fixed must be reasonable, and mandatory provisions of the charter, statute, or by-laws as to the time must be complied with.¹⁸ As a rule, however, a provision in the charter or by-laws of a corporation, authorizing corporate meetings at a certain time, is not intended to, and does not, prevent meetings at other times on proper notice.¹⁹ As against absent stockholders or members, a meeting is not legal if held before the day or hour specified in the notice of the meeting.²⁰ And when an hour for a meeting is fixed by the notice, the meeting should be opened at that hour, or within a reasonable time thereafter.²¹ In the absence of any express provision on the subject, meetings may be held at any place within the state, provided it is a reasonably convenient place.²² As against stockholders who are not present, and who do not consent, a meeting held at a different place from that specified in the notice of the meeting is a nullity.²³

Many of the courts have held that any exercise of strictly corporate functions at a corporate meeting—as the election of directors or other officers, making by-laws, making calls, voting an increase of stock, authorizing execution of a mortgage, etc.—are void, in the absence of elements of estoppel, if done at a meeting held without the state.²⁴ This doctrine has not been followed to the full extent in all jurisdictions. On the contrary, some courts have held that where a corporation has been organized within the state, so as

L. Ed. 488; *Columbia Nat. Bank of Tacoma v. Mathews*, 85 Fed. 934; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 17 Sup. Ct. 530.

¹⁷ *Scanlan v. Snow*, 2 App. D. C. 137.

¹⁸ *Miller v. English*, 21 N. J. Law 317; *Pond v. Vermont Valley R. Co.*, Fed. Cas. No. 11264; *State v. Conklin*, 34 Wis. 21.

¹⁹ *People v. Town of Fairbury*, 51 Ill. 149; *Scanlan v. Snow*, 2 App. D. C. 137; *Beardsley v. Johnson*, 121 N. Y. 224, 24 N. E. 380, aff'g 49 Hun (N. Y.) 607, 1 N. Y. Supp. 608; *In re Hammond*, 139 Fed. 898. Power of directors to change time for regular meeting of stockholders, see notes, 2 A. L. R. 558; 8 A. L. R. 678.

²⁰ *People v. Albany & S. R. Co.*, 55 Barb. (N. Y.) 344. But stockholders who are present and take part

cannot complain. *Hussey v. Gallagher*, 61 Ga. 86.

²¹ *State v. Bonnell*, 35 Ohio St. 10.

²² *Commonwealth v. Smith*, 45 Pa. St. 59.

²³ *Miller v. English*, 21 N. J. Law 317; *American Primitive Society v. Pilling*, 24 N. J. Law 653.

²⁴ *Miller v. Ewer*, 27 Me. 509, 46 Am. Dec. 619; *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339; *Ormsby v. Vermont Copper Min. Co.*, 56 N. Y. 623; *Hilles v. Parrish*, 14 N. J. Eq. 380; *Duke v. Taylor*, 37 Fla. 64, 19 So. 172, 31 L. R. A. 484, 53 Am. St. Rep. 232; *Craig Silver Co. v. Smith*, 163 Mass. 262, 39 N. E. 1116; *Harding v. American Glucose Co.*, 182 Ill. 551, 55 N. E. 577, 64 L. R. A. 738, 74 Am. St. Rep. 189; *Hening & Hagedorn v. Glanton*, 27 Ga. App. 339, 108 S. E. 256.

to acquire a valid corporate existence, and the stockholders or members of the corporation afterwards meet in another state and elect officers, their proceedings are not absolutely void, but the officers, if they act as such, are at least officers *de facto*, and their authority to act on behalf of the corporation cannot be collaterally attacked.²⁵ And it has also been held that, in the absence of an express charter or statutory provision to the contrary, if all the stockholders of a corporation are present and take part, in person or by proxy, at a meeting held without the limits of the state, they and the corporation will be estopped to deny the validity of their proceedings, and that, if all are not present, those who are present and take part will be estopped.²⁶ But there can be no estoppel against those who do not take part or acquiescence in the proceedings.²⁷ The legislature may no doubt expressly authorize the holding of corporate meetings beyond the limits of the state, or, except as against stockholders who were not present, and whose rights would be violated, validate proceedings taken at such a meeting.²⁸

When corporations existing under the laws of different states are consolidated, or a corporation of one state is also created a corporation under the laws of other states, it has a legal domicile and existence in each state, and corporate meetings may be held and business transacted by the stockholders in either state, so as to bind the corporation and its property everywhere, without a repetition of the meeting and proceedings in the other states.²⁹

²⁵ *Ohio & M. R. Co. v. McPherson*, 35 Mo. 13, 86 Am. Dec. 128; *Ellsworth v. National Home & Town Builders*, 33 Cal. App. 1, 164 Pac. 14. *Contra*, *Miller v. Ewer*, 27 Me. 509, 46 Am. Dec. 619.

²⁶ *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; *Heath v. Silverthorn Lead Mining & Smelting Co.*, 39 Wis. 146; *Missouri Lead Mining & Smelting Co. v. Reinhard*, 114 Mo. 218, 21 S. W. 488, 35 Am. St. Rep. 746. But see *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339; *Ellsworth v. National Home & Town Builders*, 33 Cal. App. 1, 164 Pac. 14.

²⁷ *Ormsby v. Vermont Copper Min. Co.*, 56 N. Y. 623; *Hilles v. Parrish*, 14 N. J. Eq. 380.

If the general law or the charter

or by-laws of a corporation expressly provide that corporate meetings shall be held within the state, a meeting held in another state is a nullity as against stockholders who do not participate or consent. *Hodgson v. Duluth, H. & D. R. Co.*, 46 Minn. 454.

²⁸ *Graham v. Boston, H. & E. R. Co.*, 118 U. S. 161, 30 L. Ed. 196, 6 Sup. Ct. 1009.

A general clause in a charter or general law authorizing the directors to call a meeting of stockholders at such place as they think proper does not authorize a meeting in another state. *Miller v. Ewer*, 27 Me. 509, 46 Am. Dec. 619.

²⁹ *Graham v. Boston, H. & E. R. Co.*, 118 U. S. 161, 30 L. Ed. 196, 6 Sup. Ct. 1009; *Covington & C. Bridge Co. v. Mayer*, 31 Ohio St. 317.

§ 169. Conduct of corporate meetings and elections.

The mode of conducting corporate elections may be regulated by by-laws, if they are reasonable and not inconsistent with the charter.³⁰ If a meeting is held or conducted fraudulently or unfairly, even though a majority of the stockholders or members may express their assent, it will be illegal, and a court of equity will set the proceedings aside at the suit of injured stockholders or members.³¹

In the case of a select board, like a board of directors, a majority of the members is necessary to constitute a quorum, and a less number cannot hold a meeting and transact business; but this rule does not apply to a meeting of the stockholders or members of a corporation. In the absence of express provision to the contrary, any number who may be present, provided there are at least two, and assuming that notice of the meeting has been given, when necessary, constitute a quorum for the transaction of business.³² Sometimes, however, by express provision of the statute, charter, or by-laws, a majority of the members or stockholders, or persons representing a majority of the stock, or sometimes more or less, are necessary to constitute a quorum for the transaction of business, and less than the required number cannot hold a valid meeting, although they may adjourn.³³

When a quorum is present at a corporate meeting, so that it may be held, the vote of a majority of those present is sufficient to elect directors or other officers, or to decide any question, unless there is some express provision to the contrary, although they may not be a majority of all the stockholders or members, nor own a majority of the stock.³⁴ And by the weight of authority, a majority of the

³⁰ *Commonwealth v. Woelper*, 3 Serg. & R. (Pa.) 29, 8 Am. Dec. 628; *Juker v. Com.*, 20 Pa. St. 484; *Kearney v. Andrews*, 10 N. J. Eq. 70.

³¹ *People v. Albany & S. R. Co.*, 55 Barb. (N. Y.) 344, 38 How. Pr. 228; *Johnston v. Jones*, 23 N. J. Eq. 216; *State v. Smith*, 15 Ore. 98, 14 Pac. 814, 15 Pac. 137, 386; *Commonwealth v. Patterson*, 153 Pa. St. 476, 27 Atl. 998.

³² *Ex parte Willecocks*, 7 Cow. (N. Y.) 402, 17 Am. Dec. 525; *Field v. Field*, 9 Wend. (N. Y.) 394; *Morrill v. Little Falls Mfg. Co.*, 53 Minn. 371, 55 N. W. 547, 21 L. R. A. 174. The Minnesota court said: "It is immaterial whether the number present is only one or more than one."

³³ *In re Gulla*, 13 Del. Ch. 23, 115 Atl. 317; *Ellsworth Woolen Mfg. Co. v. Faunce*, 79 Me. 440, 10 Atl. 250; *Weinburgh v. Union Street-Railway Advertising Co.*, 55 N. J. Eq. 640, 37 Atl. 1026; *Peirce v. New Orleans Building Co.*, 9 La. 397, 29 Am. Dec. 448; *Franklin Trust Co. v. Rutherford*, *Boiling Springs & Carlstadt Elec. Co.*, 57 N. J. Eq. 42, 41 Atl. 488; *Clark v. Wild*, 85 Vt. 212, 81 Atl. 536, Ann. Cas. 1914 C 661.

³⁴ *State v. Chute*, 34 Minn. 135, 24 N. W. 353; *Craig v. First Presbyterian Church of Pittsburgh*, 88 Pa. St. 42, 32 Am. Rep. 417; *In re Rapid Transit Ferry Co.*, 15 N. Y. App. Div. 530, 44 N. Y. Supp. 539; *Schwartz v. State*, 61 Ohio St. 497,

votes actually cast will decide, although some of the stockholders or members who are present may refuse to vote, and the majority of the votes cast may not be by a majority of the persons present or stock represented.³⁵ A by-law or charter provision requiring the affirmative vote of a majority of the stockholders at a corporate meeting means a majority in interest rather than a majority in number only.³⁶

II. THE RIGHT TO VOTE AT CORPORATE MEETINGS, AND VOTING AGREEMENTS.

§ 170. Who are entitled to vote.—With respect to the right to vote at corporate meetings and elections, the following general rules may be stated:

- (1) Every stockholder or member has a right to vote, unless there is some charter or statutory provision to the contrary, or he has surrendered his right by a valid agreement.
- (2) If shares have been transferred, the right to vote is in the transferee, in the absence of an agreement or a charter or statutory provision to the contrary.
- (3) The right of stockholders to vote may be restricted by provisions in the articles, or by a general statute or constitutional provision in force at the time the corporation was formed, or enacted or adopted afterwards, and assented to by all the stockholders.
- (4) By-laws adopted by a majority of the stockholders may regulate the right to vote, if they are reasonable, and not inconsistent with the charter of the corporation, and do not impair the rights of dissenting stockholders; but a by-law cannot deprive a stockholder of the right to vote given him by the charter or general law without his consent.
- (5) The stock or transfer books are at least *prima facie* evidence of who are stockholders and entitled to vote. In some states, by statute, they are conclusive evidence.

56 N. E. 201; *Hill v. Town*, 172 Mich. 508, 138 N. W. 334, 42 L. R. A. (N. S.) 799.

³⁵ *Inhabitants of First Parish in Sudbury v. Stearns*, 21 Pick. (Mass.) 148; *State v. Chute*, 34 Minn. 135, 24 N. W. 353; *Columbia Bottom*

Levee Co. v. Meier, 39 Mo. 53. But see *Commonwealth v. Wickersham*, 66 Pa. St. 134.

³⁶ *Weinburgh v. Union Street-Railway Advertising Co.*, 55 N. J. Eq. 640, 37 Atl. 1026. See also, *In re Argus Printing Co.*, 1 N. D. 434, 48

- (6) Generally, in the absence of provision or agreement to the contrary, a pledgee of stock is entitled to vote if the stock is registered in his name on the books of the corporation, but not otherwise. In some states, the question is regulated by statute.
- (7) Persons holding stock as trustees have the right to vote the same.
- (8) Executors are entitled to vote stock standing on the books in the name of their testator.
- (9) Stock held by the corporation in itself, or by a trustee for it, or its pledgee, cannot be voted.
- (10) A corporation holding stock in another corporation has a right to vote the same, unless the purchase or subscription was *ultra vires*, or unless the voting of the same is contrary to the public policy of the state.
- (11) Stock owned jointly by two or more persons, either in their own right, or as executors or trustees, cannot be voted if they disagree.
- (12) A stockholder is not precluded from voting by the fact that he has a personal interest apart from his interest as a stockholder.

In the absence of express charter or statutory provision to the contrary, the general rule is that every member of a corporation not having a capital stock, and every legal owner of shares in a stock corporation, has a right to be present and vote at all corporate meetings;³⁷ Any transfer of stock that is sufficient to pass the title is sufficient to entitle the transferee to vote the stock, unless some specific mode of transfer is made necessary by the charter or by-laws of the corporation or a general law.³⁸ In the absence of express provision to the contrary, the rule is that the right to vote shares of stock is in the person who has the legal title, and this is to be determined, at least *prima facie*, from the books of the corporation.^{38a}

N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; Bank of Los Banos v. Jordan, 167 Cal. 327, 139 Pac. 691.

³⁷ Pender v. Lushington, 6 Ch. Div. 70; Commonwealth v. Dalzell, 152 Pa. St. 217, 25 Atl. 535, 34 Am. St. Rep. 640; Taylor v. Griswold, 14 N. J. Law 222, 27 Am. Dec. 33; Stokes v. Continental Trust Co., 186 N. Y. 285,

78 N. E. 1090, 12 L. R. A. (N. S.) 969, 9 Ann. Cas. 738.

³⁸ People v. Devin, 17 Ill. 84. As to the necessity of registration of a transfer on the books of the corporation, see *infra*, this section.

^{38a} Pender v. Lushington, 6 Ch. Div. 70; Commonwealth v. Dalzell, 152 Pa. St. 217, 34 Am. St. Rep. 640;

Charter or statutory provisions.—Where the charter or general law expressly declares who shall be entitled to vote, and how they shall be entitled to vote, or imposes other restrictions, its provisions are controlling.³⁹ The charter or statutes may restrict the right to vote to persons who are registered as stockholders on the books of the corporation, or limit the number of votes to be cast by any one stockholder, or divide the stock into classes, and withhold the voting privilege from any class of stock,⁴⁰ or restrict the right to vote to actual *bona fide owners* of stock,⁴¹ or to persons who have held stock for a certain length of time.⁴² The charter may exclude preferred stockholders from the right to vote, except as this is limited by the constitution or statutes, in consideration of the preference over the common stock which is given them.⁴³ But it is held in Illinois that preferred stock without voting power cannot be issued by a corporation under a constitutional provision that every stockholder shall have the right to vote for the number of shares of stock owned by him.⁴⁴

There has been much recent discussion of the increasing use of the device of issuing large blocks of shares in a company without the privilege of voting on its directors, while smaller blocks or classes, closely held, retain the power exclusively. It is argued on the one hand that the vesting of such control in the active promoters

Hoppin v. Buffum, 9 R. I. 513, 11 Am. Rep. 291; *In re Argus Printing Co.*, 1 N. D. 435, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; *State v. Ferris*, 42 Conn. 560; *Royal Consol. Min. Co. v. Royal Consol. Mines Co.*, 157 Cal. 737, 110 Pac. 123, 137 Am. St. Rep. 165.

³⁹ *Brewster v. Hartley*, 37 Cal. 15, 99 Am. Dec. 237; *People's Home Sav. Bank v. Superior Court of City and County of San Francisco*, 104 Cal. 649, 38 Pac. 452, 29 L. R. A. 844, 43 Am. St. Rep. 147; *Durkee v. People ex rel. Askren*, 155 Ill. 354, 40 N. E. 626, 46 Am. St. Rep. 340.

⁴⁰ *Mack v. DeBardleben Coal & Iron Co.*, 90 Ala. 396, 8 So. 150, 9 L. R. A. 650; *Campbell v. Poultney*, 6 Gill & J. (Md.) 94, 26 Am. Dec. 559; *Webb v. Ridgely*, 38 Md. 364; *General Inv. Co. v. Bethlehem Steel Corp.*, 87 N. J. Eq. 234, 100 Atl. 350. See note, 21 A. L. R. 643, right to issue corporate stock without voting power.

⁴¹ *Smith v. San Francisco & N. P. Ry. Co.*, 115 Cal. 584, 47 Pac. 582, 35 L. R. A. 309, 56 Am. St. Rep. 119;

Royal Consol. Min. Co. v. Royal Consol. Mines Co., 157 Cal. 737, 110 Pac. 123, 137 Am. St. Rep. 165; *Haynes v. Griffith*, 16 Idaho 280, 101 Pac. 728. See California Civ. Code, sec. 312.

⁴² *Van Dyke v. Stout*, 8 N. J. Eq. 333. See also, *In re Leslie*, 58 N. J. Law 609, 33 Atl. 954; *In re Vernon*, 1 Pennewill (Del.) 202, 40 Atl. 60; *In re Glen Salt Co.*, 17 N. Y. App. Div. 234, 45 N. Y. Supp. 568.

⁴³ *Millsbaugh v. Cassedy*, 191 N. Y. App. Div. 221, 181 N. Y. Supp. 276; *People ex rel. Browne v. Koenig*, 133 N. Y. App. Div. 756, 118 N. Y. Supp. 136; *General Inv. Co. v. Bethlehem Steel Corp.*, 87 N. J. Eq. 234, 100 Atl. 347; *Randle v. Winona Coal Co.*, 206 Ala. 254, 89 So. 790, 19 A. L. R. 118.

⁴⁴ *People ex rel. Watseka Tel. Co. v. Emmerson*, 302 Ill. 300, 134 N. E. 707, 21 A. L. R. 636, 643 n. See also, *Film Producers v. Jordan*, 171 Cal. 664, 154 Pac. 605; *Del Monte Light & Power Co. v. Jordan*, 196 Cal. 488, 238 Pac. 710.

and managers so that no other group can dislodge them is for the benefit of the enterprise. But it may be questioned whether the permanent benefit is so guaranteed and whether the arrangement does not deprive the investor in the non-voting shares of a potential control which should be his means of self-defense.⁴⁵ In any event, "the management stock must exercise its voting rights subject to all the rules limiting directors and others in a fiduciary capacity in the exercise of management powers."⁴⁶ The management shareholders are not free to consider their own interests only, when other classes of nonvoting stock represent the substantial investment of capital.

Mr. Seligman made the following suggestion as to voting rights in a paper presented to the American Bar Association: "* * * The persons who share in the profits and the losses should share in the same proportion in the control. A most flagrant violation of this principle appeared in connection with a recent sale to the public of securities of a nationally known automobile company; here the entire investment was made by the public who, however, were given no voting powers, while the promoters who not only made no investment, but on the contrary received a tremendous profit from the transaction, retained the entire voting power. This situation cannot be justified and accordingly it is suggested that corporation laws should be changed wherever necessary in order to require that every common stockholder should have the right to vote for directors.

"The foregoing suggestion has been limited to the rights of common stockholders. A similar question arises as to preferred stockholders and even bondholders. Here, however, it can be argued that these classes of securityholders are not the real owners of the

⁴⁵ W. Z. Ripley, "From Main Street to Wall Street," 137 Atlantic Monthly, 94 (Jan. 1926). See *Lord v. Equitable Life Assur. Soc. of United States*, 194 N. Y. 212, 228, 87 N. E. 443, 448, 22 L. R. A. (N. S.) 420, Vann, J.: "The right to vote for directors, therefore, is the right to protect property from loss and make it effective in earning dividends. Unless the stockholder can protect his investment in this way he cannot protect it at all, and his property might be wasted by a feeble administration and he could not prevent it."

Under the California Constitution,

Art. XII, sec. 12, and Civil Code, secs. 290, (6), 307, it is held that the right to vote is required to be in proportion to the interest of the shareholders in the capital stock, i. e., in proportion to the supposed investment in the corporation represented by stock. Accordingly different par values would be violative of the policy of the law. *Del Monte Light & Power Co. v. Jordan*, 196 Cal. 488, 238 Pac. 710, 13 California Law Rev. 483; *Film Producers, Int. v. Jordan*, 171 Cal. 664, 154 Pac. 605.

⁴⁶ Berle, Non-voting stock and banker's control, 39 Harvard Law Rev. 673.

business but merely creditors or quasi-creditors. On the other hand, bondholders of a railroad are in a very different category from a bank making a six months' loan to an individual; they are in reality part owners of the company even though limited as to profits and preferred in case of losses, and they are treated differently from bank creditors in reorganization plans and they are directly affected by many decisions of the board of directors. The laws of some states, such as Delaware, recognize the situation by providing that bondholders may be given voting rights."⁴⁷

By-laws affecting the right to vote.—A majority of the stockholders or members of a corporation may adopt reasonable by-laws, not inconsistent with the charter or any statute, regulating the method of voting at corporate elections;⁴⁸ and a by-law may take away or restrict a stockholder's right to vote if he consents to it.⁴⁹ But it is not within the power of the majority to deprive a stockholder or member, without his consent, of the right to vote, or the number of votes, which he has by virtue of the charter and of his contract of membership, or to impose new qualifications, or unreasonable restrictions upon the exercise of the right.⁵⁰ And when the charter or general law prescribes that stockholders shall be entitled to vote, the right to vote at stockholders' meetings cannot be conferred upon bondholders by a by-law.⁵¹

⁴⁷ Seligman, 50 Reports American Bar Ass'n [1925], 851, Broader legal aspects of customer stock ownership. Perhaps a fair compromise would be to give both preferred stockholders and bondholders voting rights when earnings have fallen below a certain ratio to dividend or interest requirements.

⁴⁸ State v. Tudor, 5 Day (Conn.) 329, 5 Am. Dec. 162; Beckett v. Houston, 32 Ind. 393; Commonwealth v. Woelper, 3 Serg. & R. (Pa.) 29, 8 Am. Dec. 628; Commonwealth v. Detwiller, 131 Pa. St. 614, 18 Atl. 990, 7 L. R. A. 357.

⁴⁹ Commonwealth v. Detwiller, 131 Pa. St. 614, 18 Atl. 990, 7 L. R. A. 357. As to restrictions by consent or agreement on the voting power, see State ex rel. Frank v. Swanger, 190 Mo. 561, 89 S. W. 872, 2 L. R. A. (N. S.) 121, 4 Ann. Cas. 563; Fletcher, Corporations, sec. 1660.

⁵⁰ St. Luke's Church v. Mathews,

4 Desaus. (S. C.) 578, 6 Am. Dec. 619; People's Home Sav. Bank v. Superior Court of City and County of San Francisco, 104 Cal. 649, 38 Pac. 452, 29 L. R. A. 844, 43 Am. St. Rep. 147; Taylor v. Griswold, 14 N. J. Law 222, 27 Am. Dec. 33; Durkee v. People ex rel. Askren, 155 Ill. 354, 40 N. E. 626, 46 Am. St. Rep. 340; Loewenthal v. Rubber Reclaiming Co., 52 N. J. Eq. 440, 28 Atl. 454; In re Timen, 120 N. Y. Misc. Rep. 815, 200 N. Y. Supp. 488, the right of a stockholder to vote under the New York general corporation law cannot be taken away by a by-law that only those stockholders whose names appear on the stock transfer book may vote. Their names might appear on the stock ledger or other books.

⁵¹ Durkee v. People ex rel. Askren, 155 Ill. 354, 40 N. E. 626, 46 Am. St. Rep. 340.

Stockholders having a personal interest.—At a stockholders' meeting, each stockholder represents himself and his own interests solely, and in no sense acts as a trustee or representative of others, and his right to vote upon a measure coming before the meeting is not in any way affected by the fact that he has a personal interest therein different or separate from that of the other stockholders.⁵² And a stockholder, unlike an officer, is not precluded, by the fact that he is personally interested, from voting for a contract or other measure at a corporate meeting.⁵³ In the *Windmuller* case⁵⁴ that arose under the New Jersey laws, the holders of the preferred and common stock of a manufacturing company had transferred all the common stock to a holding company in consideration of a guaranty by the holding company of dividends on the preferred stock during the existence of the manufacturing company, which seem to have been unlimited. The New Jersey statute permitted corporations to go into voluntary dissolution upon vote of two-thirds of the stock. It was held by the federal court that the holding company would not be enjoined from voting the common stock in favor of dissolution of the manufacturing company. The effect of the dissolution would be to enable the holding company to escape from its contract with the preferred stockholders to guarantee their dividends.

It has been pointed out that the ground of action in this case, if any, was the implied term of every contract to do nothing to render performance impossible, not upon any obligation resting

⁵² *Du Pont v. Du Pont*, 251 Fed. 937, 944, s. c. 256 Fed. 129; *Windmuller v. Standard Distilling & Distributing Co.*, 115 Fed. 748; s. c., 114 Fed. 491; *Walsh v. State ex rel. Cook*, 199 Ala. 123, 74 So. 45, 2 A. L. R. 551; *North-West Transportation Co. v. Beatty*, 12 App. Cas. 589; *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527; *Bjorngaard v. Goodhue County Bank*, 49 Minn. 483, 52 N. W. 48; *Merriman v. National Zinc Corp.*, 82 N. J. Eq. 493, 89 Atl. 764; *Stanley v. Luse*, 36 Ore. 25, 58 Pac. 75; *Thurmond v. Paragon Colliery Co.*, 82 W. Va. 49, 95 S. E. 816; *Camden & A. R. Co. v. Elkins*, 37 N. J. Eq. 273; *Dunbar v. American Telephone & Telegraph Co.*, 224 Ill. 9, 79 N. E. 423, 115 Am. St. Rep. 132, 8 Ann. Cas. 57. Cf. *Memphis & C. R. Co. v. Woods*, 88 Ala. 630, 7 So. 108, 7

L. R. A. 605, 16 Am. St. Rep. 81; *Palmbaum v. Magulsky*, 217 Mass. 306, 104 N. E. 746, Ann. Cas. 1915 D 799 (duty to act fairly and in good faith).

⁵³ *North-West Transportation Co. v. Beatty*, 12 App. Cas. 589; *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527; *Bjorngaard v. Goodhue County Bank*, 49 Minn. 483, 52 N. W. 48; ante, § 124. See *Blinn v. Riggs*, 110 Ill. App. 37; *Camden & A. R. Co. v. Elkins*, 37 N. J. Eq. 273 (directors of a corporation cannot dispute the right of a stockholder to vote on the ground that he became the purchaser of the stock with the money of rival companies, and that he contemplates the use of his voting power for purposes detrimental to the corporation and in the interest of its rivals).

⁵⁴ *Supra*, note 52.

upon a stockholder to vote for the welfare of the corporation. If the complainants had attacked the action of the directors in instituting proceedings for dissolution as a fraudulent scheme against the minority a strong case might have been made out.⁵⁵ Majority stockholders, however, as we shall see, will not be allowed to control the corporation in the interest of themselves individually, and in fraud of the rights of the minority.⁵⁶ Thus it has been held that dissolution will be restrained where the sole immediate purpose was to get rid of the minority stockholders. There is a growing tendency to hold that majority stockholders stand in a fiduciary relation, in the sense that they cannot dishonestly exercise their voting power to secure an advantage to themselves over the minority.⁵⁷

Stock or transfer books as evidence—Unregistered transfers.—

In most jurisdictions the transfer or other stock books of a corporation are, by express statutory provision, made conclusive evidence of who are stockholders and entitled to vote, and the inspectors or other officers have no power to inquire further.⁵⁸ In other jurisdictions, by express provision, and even in the absence of such provision where stock is transferrable on the books, the books are *prima facie* evidence of the right to vote.⁵⁹ The inspectors or other officers cannot be required to decide, or decide, a

⁵⁵ See *Robotham v. Prudential Ins. Co. of America*, 64 N. J. Eq. 673, 690, 53 Atl. 842; 25 Harvard Law Rev. 677, 683; 2 Minnesota Law Rev. 526; 13 Yale Law Journal 119.

There was no attempt by the holding company in the *Windmuller* case to destroy a contract beneficial to the corporation itself, but to escape from an individual contract onerous to the stockholders voting for dissolution.

⁵⁶ Post, § 175.

⁵⁷ In *re Paine*, 200 Mich. 58, 166 N. W. 1036; *Turner v. Calumet & Hecla Min. Co.*, 187 Mich. 238, 153 N. W. 718; *Farmers Loan & Trust Co. v. New York & N. R. Co.*, 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689; 22 Harvard Law Rev. 591; 25 Harvard Law Rev. 677, 683; 9 Columbia Law Rev. 357; 2 Minnesota Law Rev. 526.

⁵⁸ *People v. Tibbits*, 4 Cow. (N. Y.) 358; *Ex parte Willcocks*, 7 Cow. (N. Y.) 402, 17 Am. Dec. 525; *Downing v. Potts*, 23 N. J. Law 66; In *re*

Cedar Grove Cemetery Co., 61 N. J. Law 422, 39 Atl. 1024; In *re Leslie*, 58 N. J. Law 609, 33 Atl. 954; In *re Argus Printing Co.*, 1 N. D. 434, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; *Pender v. Lushington*, 6 Ch. Div. 70, 46 Law J. Ch. Div. 317. See In *re United States Cast Iron Pipe & Foundry Co.*, 74 N. J. L. 315, 65 Atl. 849; In *re Zenitherm Co.*, 95 N. J. Law 297, 113 Atl. 327. But see *Smith v. San Francisco & N. P. Ry. Co.*, 115 Cal. 584, 47 Pac. 582, 35 L. R. A. 309, 56 Am. St. Rep. 119, 138 n.

⁵⁹ *Commonwealth v. Dalzell*, 152 Pa. St. 217, 25 Atl. 535, 34 Am. St. Rep. 640; *Commonwealth v. Patterson*, 158 Pa. St. 476, 27 Atl. 998; *State v. Ferris*, 42 Conn. 560; *Hopkin v. Buffum*, 9 R. I. 513, 11 Am. Rep. 291; *Reynolds v. Bridenthal*, 57 Neb. 280, 77 N. W. 658; *People v. Robinson*, 64 Cal. 373, 1 Pac. 156; *Bernheim v. Louisville Property Co.*, 221 Fed. 273.

dispute as to title to stock.⁶⁰ In the absence of a provision making the books conclusive evidence of the right to vote, they are merely *prima facie* evidence, and the real owner of stock, if he produces evidence of his right, is entitled to vote.⁶¹ But when, by statute, stock is transferable only on the books of the corporation, a transferee cannot vote stock until his transfer has been registered. His remedy is in equity to compel the corporation to register the transfer, or to compel the transferrer to give him a proxy to vote, and until this is done he cannot vote.⁶²

Pledgor and pledgee.—In the absence of statutory provision to the contrary, when a pledgee of shares appears on the books of the corporation as the absolute holder of the legal title, or, if the pledgor does not claim the right, even when he appears thereon as the holder of the title as collateral security merely, he is entitled to vote the shares.⁶³ But the pledgor of shares is entitled to vote them, in the absence of agreement to the contrary, if they remain in his name on the books, or, even when they are on the books in the name of the pledgee, if the books are not made conclusive evidence of the right to vote.⁶⁴ Even when shares are on the books in the name of the pledgee, he has not the legal title, as between himself and the pledgor, and as between them the right to vote is in the pledgor, in the absence of agreement to the contrary. And it has been held, therefore, that, if necessary, he may sue in equity to compel the pledgee to transfer the shares to him, for the purpose of voting, or to give him a proxy to vote them.⁶⁵ In some jurisdictions, the right to vote as between pledgor and pledgee is regulated by statute.

⁶⁰ *Hoppin v. Buffum*, 9 R. I. 513, 11 Am. Rep. 291. See *Morawetz, Corporations* (2nd Ed.), sec. 484.

⁶¹ *People v. Devin*, 17 Ill. 84. See *People v. Hill*, 16 Cal. 113.

⁶² *In re Argus Printing Co.*, 1 N. D. 434, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; *Morrill v. Little Falls Mfg. Co.*, 53 Minn. 371, 55 N. W. 547, 21 L. R. A. 174.

⁶³ *Hoppin v. Buffum*, 9 R. I. 513, 11 Am. Rep. 291; *Commonwealth v. Dalzell*, 152 Pa. St. 217, 25 Atl. 535, 34 Am. St. Rep. 640; *Ex parte Willcocks*, 7 Cow. (N. Y.) 402, 17 Am. Dec. 525; *In re Barker*, 6 Wend. (N. Y.) 509; *In re Argus Printing Co.*, 1 N. D. 434, 48 N. W. 347, 12 L. R.

A. 781, 26 Am. St. Rep. 639; *Vail v. Hamilton*, 85 N. Y. 453; *Hardman v. Barrow*, 147 Ga. 617, 95 S. E. 209.

⁶⁴ *Merchants' Bank v. Cook*, 4 Pick. (Mass.) 405; *Ex parte Willcocks*, 7 Cow. (N. Y.) 402, 17 Am. Dec. 525; *In re Barker*, 6 Wend. (N. Y.) 509; *McHenry v. Jewett*, 26 Hun (N. Y.) 453, rev'd 90 N. Y. 58; *In re Argus Printing Co.*, 1 N. D. 434, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639. See *Spreckles v. Nevada Bank of San Francisco*, 113 Cal. 272, 45 Pac. 329, 33 L. R. A. 459, 54 Am. St. Rep. 348.

⁶⁵ *Vowell v. Thompson*, 3 Cranch. C. C. 428, Fed. Cas. No. 17023; *In re Argus Printing Co.*, 1 N. D. 434, 48

Trustees—Executors.—A person who appears on the books of a corporation or otherwise as the absolute owner of stock clearly has the right to vote, although in fact he may hold the same as trustee. And even when shares are in the name of a person as trustee on the books, he is entitled to vote them unless the *cestui que trust* objects, and takes steps to have them registered in his own name.⁶⁶

An executor or administrator has the right, in some states by express statutory provision, to vote shares belonging to the estate of his decedent, and it can make no difference that the shares stand on the books of the corporation in the name of the decedent.⁶⁷

Right of corporation to vote its own shares.—Shares of its own stock purchased or otherwise acquired by a corporation, or unissued shares, are in suspension until they are reissued or issued. A corporation cannot, in any proper sense, be a stockholder in itself, and shares of its own stock, therefore, held by a corporation, cannot be voted.⁶⁸ Shares owned by the corporation cannot be voted even when they are held in the name of a trustee for it,⁶⁹ or have been pledged by it.⁷⁰

N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639; Hoppin v. Buffum, 9 R. I. 513, 11 Am. Rep. 291; Canadian Imp. Co. v. Lea, 74 N. J. Eq. 234, 69 Atl. 455.

⁶⁶ In re Barker, 6 Wend. (N. Y.) 509; In re Mohawk & H. R. Co., 19 Wend. (N. Y.) 135; Hoppin v. Buffum, 9 R. I. 513, 11 Am. Rep. 291; Haines v. Kinderhook & H. Ry. Co., 33 N. Y. App. Div. 156, 157, 53 N. Y. Supp. 368; Commonwealth v. Daltzell, 152 Pa. St. 217, 25 Atl. 535, 34 Am. St. Rep. 640; Farmers' Loan & Trust Co. v. Toledo & S. H. R. Co., 54 Fed. 759. See Clowes v. Miller, 60 N. J. Eq. 179, 47 Atl. 345.

If trustees cannot agree how to vote the stock, they cannot vote it at all (Townsend v. Winburn, 107 N. Y. Misc. 443, 177 N. Y. Supp. 757). The trustee in the case of a dry trust may be required to give a proxy. American Nat. Bank v. Oriental Mills, 17 R. I. 551, 23 Atl. 795.

⁶⁷ Schmidt v. Mitchell, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427;

Market Street Ry. Co. v. Hellman, 109 Cal. 571, 42 Pac. 225; In re Cape May & Delaware Bay Nav. Co., 51 N. J. Law 78, 16 Atl. 191; Billings v. Marshall Furnace Co., 210 Mich. 1, 177 N. W. 222, 9 A. L. R. 1239; Glake v. Arnett, 38 Idaho 736, 225 Pac. 796.

⁶⁸ Ex parte Holmes, 5 Cow. (N. Y.) 426; Vail v. Hamilton, 20 Hun (N. Y.) 355, aff'd 85 N. Y. 453; State v. Smith, 48 Vt. 266; American Railway Frog Co. v. Haven, 101 Mass. 398, 3 Am. Rep. 377; Walsh v. State ex rel. Cook, 199 Ala. 123, 74 So. 45, 2 A. L. R. 551; Tapper v. Boston Chamber of Commerce, 235 Mass. 209, 126 N. E. 464.

⁶⁹ American Railway Frog Co. v. Haven, 101 Mass. 398, 3 Am. Rep. 377; Tapper v. Boston Chamber of Commerce, 235 Mass. 209, 126 N. E. 464.

⁷⁰ Brewster v. Hartley, 37 Cal. 15, 99 Am. Dec. 237; Thomas v. International Silver Co., 72 N. J. Eq. 224, 73 Atl. 833.

Right of corporations to vote upon stock of another corporation held by it.—In general, a corporation holding stock in other corporations, and having authority to do so under its charter, is entitled to vote the stock to the same extent as any other stockholder.⁷¹ But when a corporation has no power under its charter to acquire and hold stock in another corporation, and nevertheless purchases the same *ultra vires*, it cannot compel the other corporation to transfer the stock to it on its books, so as to entitle it to vote, or vote after such a transfer has been made.⁷² A corporation, even when it has the power to purchase and hold stock, may be enjoined from voting stock held by it in another corporation at a meeting of the latter for the election of directors or other business, where it appears that its purpose is to control the other corporation in its own interest, or in the interest of its own officers or stockholders, or where it is seeking to create a monopoly.^{72a}

Right to vote shares owned jointly.—If shares are owned by two or more persons jointly, the right to vote is in them jointly, and, in order that the shares may be voted, they must agree upon the vote.⁷³ This applies to shares held by several executors or trustees.⁷⁴

⁷¹ *Bigelow v. Calumet Hecla Min. Co.*, 167 Fed. 721; *Rogers v. Nashville, C. & St. L. Ry. Co.*, 91 Fed. 299; *Davis v. United States Elec. Power & Light Co.*, 77 Md. 35, 25 Atl. 932; *Oelbermann v. New York & N. Ry. Co.*, 76 Hun (N.Y.) 613, 77 Hun 332, 29 N. Y. Supp. 545.

⁷² *Franklin Bank v. Commercial Bank*, 36 Ohio St. 350, 38 Am. Rep. 594; *Milbank v. New York, L. E. & W. R. Co.*, 64 How. Pr. (N. Y.) 20; *Parsons v. Tacoma Smelting & Refining Co.*, 25 Wash. 492, 65 Pac. 765. But see *Harriman*, 13 Yale Law Journal 116, 117: "The title to the stock having vested in the purchasing corporation, the right to vote is merely one of the necessary incidents of ownership. The exercise of the rights of an owner by a corporation can never be questioned on the ground that the acquisition of the property is *ultra vires*."

^{72a} *Clarke v. Central Railroad & Banking Co.*, 50 Fed. 338, 15 L. R. A. 683; *George v. Central Railroad & Banking Co.*, 101 Ala. 607, 14 So. 752; *Memphis & C. R. Co. v. Woods*,

88 Ala. 630, 7 So. 108, 7 L. R. A. 605, 16 Am. St. Rep. 81; *State v. McDaniel*, 22 Ohio St. 354. See *Farmers' Loan & Trust Co. v. New York & N. R. Co.*, 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689; *Oelbermann v. New York & N. Ry. Co.*, 76 Hun 613, 77 Hun 332, 29 N. Y. Supp. 545 (railroad company has same voting rights as any other stockholder); *Rogers v. Nashville, C. & St. L. Ry. Co.*, 91 Fed. 299; *Dunbar v. American Telephone & Telegraph Co.*, 224 Ill. 9, 79 N. E. 423, 115 Am. St. Rep. 132, 8 Ann. Cas. 57 (right of minority stockholders to enjoin voting of stock by corporation acquired for purpose of stifling competition).

⁷³ *Tunis v. Hestonville, M. & F. Passenger R. Co.*, 149 Pa. St. 70, 24 Atl. 88, 15 L. R. A. 665; *In re Pioneer Paper Co.*, 36 How. Pr. (N. Y.) 111; *Hey v. Dolphin*, 92 Hun (N. Y.) 230, 36 N. Y. Supp. 627; *Clowes v. Miller*, 60 N. J. Eq. 179, 47 Atl. 345.

⁷⁴ *Tunis v. Hestonville, M. & F. Passenger R. Co.*, 149 Pa. St. 70, 24 Atl. 88, 15 L. R. A. 665; *Townsend v.*

§ 171. Number of votes.—At common law, each stockholder or member of a corporation is entitled to but one vote, but charter or statutory provisions or by-laws generally give stockholders the right to vote once for each share, or for each share up to a certain limit.

At common law, since the members of a corporation were entitled to equal rights, each member was entitled to one vote, and no more, and it has been held that the rule also applies to corporations having a capital stock divided into shares, and that, in the absence of express provision to the contrary, a stockholder has only one vote, however many shares he may own, and not a vote for each share.⁷⁵ In a New York case, it was held (three judges dissenting) that inspectors of election who have the function of passing on contested votes and the right to vote if challenged, might be appointed by a *per capita* vote of those present at the meeting and who had the right to vote against the objection of those who demanded a share vote.⁷⁶

It is generally expressly provided, however, by statute or by by-laws, that stockholders shall have one vote for each share held by them. Even in the absence of an express provision, the soundness of the view limiting stockholders to a single vote, however many shares they may own, is very doubtful. The common-law rule was adopted with respect to public corporations and private corporations not having a capital stock, and at a time when joint-stock corporations were unknown. Even aside from this view, the common usage in giving a vote for each share would seem to be sufficient ground for implying an intention on the part of the legislature, in the absence of express provision, to give each share

Winburn, 107 N. Y. Misc. 443, 177 N. Y. Supp. 757. Compare *Schmidt v. Mitchell*, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427.

It has been held, however, that if a will authorizes or directs that one of several executors shall vote stock belonging to the estate, and that the others shall give him proxies for the purpose, they may be compelled by the court to do so. *Lafferty's Estate*, 154 Pa. St. 430, 26 Atl. 388.

⁷⁵ *Taylor v. Griswold*, 14 N. J. Law 222, 27 Am. Dec. 33.

⁷⁶ *In re Remington Typewriter Co.*, 234 N. Y. 296, 137 N. E. 335, rev'g

203 N. Y. App. Div. 65, 196 N. Y. Supp. 309. Inspectors of election may be appointed by a *per capita* vote of those present at the meeting, and who have the right to vote. The court thus deprived the majority in interest of the right of control. See *In re Mathiason Mfg. Co.*, 122 Mo. App. 437, 446, 99 S. W. 502; *In re Horburg, etc., Co.*, 11 Ch. Div. 109; 2 *Cook, Corporations* (8th Ed.), sec. 609; *Morawetz, Corporations* (2nd Ed.), sec. 484; *Williston*, 2 *Harvard Law Rev.* 149, 156; 36 *Harvard Law Rev.* 754; 23 *Columbia Law Rev.* 396; 9 *Virginia Law Rev.* 459.

a vote.⁷⁷ The number of votes is normally proportionate to the stockholders' interest in the corporation. The privilege of share voting extends beyond the election of directors to the general conduct of the meeting, as in votes on motions, the selection of a chairman of the meetings, inspectors of election, adjournment, etc.

By the weight of authority, a corporation may make a valid by-law changing the common-law rule, and allowing stockholders to cast one vote for each share of stock held by them, instead of each stockholder being restricted to a single vote, unless the charter or general statutory law establishes a different rule.⁷⁸ For the purpose of preventing a single individual, or a few individuals, from obtaining control of a corporation, the charter or a general statute sometimes limits the number of votes which a single stockholder may cast, and the restriction cannot be evaded by colorable transfers.⁷⁹

§ 172. Cumulative voting.—The right to cumulate votes does not exist unless it is expressly authorized. If this right is given by the charter, statute, or constitution, a stockholder cannot be deprived of it by a by-law without his consent.

Cumulative voting is the privilege, where several officers are to be voted for at the same time, of casting the whole number for one person, or of distributing them as he may see fit, instead of casting one for each. It is intended to secure representation of minority stockholders on the board of directors. In the absence of express provision therefor, a stockholder has no right thus to cumulate his votes.⁸⁰ Without cumulative voting there is the possi-

⁷⁷ In re Remington Typewriter Co., 203 N. Y. App. Div. 65, 196 N. Y. Supp. 309; In re Rochester Dist. Telegraph Co., 40 Hun (N. Y.) 172; In re Mathiason Mfg. Co., 122 Mo. App. 437, 99 S. W. 502; Weinburgh v. Union Street-Railway Advertising Co., 55 N. J. Eq. 640, 37 Atl. 1026. Cf. Commonwealth v. Vandergrift, 232 Pa. 53, 81 Atl. 153, 36 L. R. A. (N. S.) 45, Ann. Cas. 1912 C 1267 (election of chairman of an annual meeting by *viva voce* vote); 23 Columbia Law Rev. 396 ("A private corporation being a business creation, it is desirable that a financial rather than a numerical majority should at all times control"); 1 Morawetz, Corporations (2d Ed.), sec. 476a.

⁷⁸ Commonwealth v. Detwiller, 131 Pa. St. 614, 18 Atl. 990, 992, 7 L. R. A. 357, 360; Proctor Coal Co. v. Finley, 98 Ky. 405, 33 S. W. 188. And see State v. Tudor, 5 Day (Conn.) 329, 5 Am. Dec. 162. But see, to the contrary, Taylor v. Griswold, 14 N. J. Law 222, 27 Am. Dec. 33.

⁷⁹ Mack v. DeBardeleben Coal & Iron Co., 90 Ala. 396, 8 So. 150, 9 L. R. A. 650. Such limitation is common in the case of co-operative marketing associations, see 8 Minnesota Law Rev. 1, 4.

⁸⁰ State v. Stockley, 45 Ohio St. 304, 13 N. E. 279; Proctor Coal Co. v. Finley, 98 Ky. 405, 33 S. W. 188; Hays v. Commonwealth, 82 Pa. St.

bility that a compact majority will elect the full board and thus control the corporation without any representatives of other classes and interests of the stockholders being present at the board meetings. The right is frequently given by the charter or by-laws of a corporation, or a general statute, and in some jurisdictions it is given by a constitutional provision.⁸¹

The object of cumulative voting as contrasted with what is known as majority voting is to enable a minority to elect a fraction of the board of directors and thus secure representation and a knowledge of affairs. If five directors are to be elected, this method enables the holders of two-fifths of the shares, by casting all their votes for two persons, to elect them as directors no matter how the majority may cast their votes. If there are five vacancies to be filled, at the annual meeting, each share of stock may be voted five times for one individual to fill one vacancy, instead of one vote for each of the five vacancies. If with five directors to be chosen, exactly one-fifth of the stock present is voted for one nominee, nothing can prevent him from getting a place on the board of directors. If each side casts its vote in due accordance with its strength at the meeting, each will elect members to the board in proportion to its voting power. But great care must be taken in calculation by both sides in properly distributing or concentrating its votes to make them effective.⁸²

§ 173. Proxies, or powers of attorney to vote shares.—The right to vote stock by proxy does not exist at common law, but is generally given by express charter or statutory provision or by-laws. A proxy to vote stock may be revoked at any time, unless coupled with an interest, although it may be in terms irrevocable.

518; *Commonwealth v. Butterworth*, 160 Pa. St. 55, 28 Atl. 507; *State v. Greer*, 78 Mo. 188.

⁸¹ *Pierce v. Commonwealth*, 104 Pa. St. 150; *Cross v. West Virginia Cent. & P. Ry. Co.*, 35 W. Va. 174, 12 S. E. 1071; *Wright v. Central California Colony Water Co.*, 67 Cal. 532, 8 Pac. 70; *Proctor Coal Co. v. Finley*, 98 Ky. 405, 33 S. W. 188; *Schwartz v. State ex rel. Schwartz*, 61 Ohio St. 497, 56 N. E. 201 (one receiving the majority of votes cast is elected a director, though he does not receive the votes of the holders of a majority of the shares); *Chi-*

cago Macaroni Mfg. Co. v. Boggiano, 202 Ill. 312, 67 N. E. 17; *In re Jamaica Consumers' Ice Co.*, 190 N. Y. App. Div. 739, 180 N. Y. Supp. 384.

That a constitutional provision allowing cumulative voting is self-executing, see *Pierce v. Commonwealth*, 104 Pa. St. 150; *State ex rel. Kemper v. Dorchester Farmers' Co-op. Grain & Live Stock Co.*, 102 Neb. 625, 168 N. W. 643.

⁸² *Clarke, California Corporations*, p. 170.

At common law it was required that all votes at corporate meetings should be given in person; and this is still the rule, with respect both to nonstock and to stock corporations, in the absence of express provision to the contrary. A stockholder or member of a corporation cannot give a proxy or power of attorney to another to represent him and vote at a corporate meeting, unless the right to do so is given by the charter or a general constitutional or statutory provision, or by a valid by-law.⁸³ The right to vote by proxy, however, is now very generally given, in the case of stock corporations, by a general statutory or constitutional provision, or by charters, or else it is provided for in the by-laws of corporations. And when the right is thus given, a stockholder cannot be deprived of it, nor can it be unreasonably restricted, by a by-law or otherwise, without his consent.⁸⁴ By the weight of authority, a by-law may be adopted by a majority of the stockholders, so as to allow voting by proxy, instead of in person, as at common law.⁸⁵ A charter or statute allowing voting by proxy, may impose restrictions on the right to vote in this way, or it may limit the right to a particular class of stockholders, and exclude another class, and the right can be exercised only as authorized.⁸⁶

Here is a form of proxy in frequent use:

“KNOW ALL MEN BY THESE PRESENTS, that I, _____ do hereby constitute and appoint _____ with power of substitution, my attorney and agent for me and in my name, place and stead, irrevocably, to

⁸³ Taylor v. Griswold, 14 N. J. Law 222, 27 Am. Dec. 33; Philips v. Wickham, 1 Paige (N. Y.) 590, 27 Am. Dec. 60n; People v. Twaddell, 18 Hun (N. Y.) 427; Commonwealth v. Bringham, 103 Pa. St. 134, 49 Am. Rep. 119; Harvey v. Linville Improvement Co., 118 N. C. 693, 24 S. E. 489, 32 L. R. A. 265, 54 Am. St. Rep. 749; McKee v. Home Savings & Trust Co., 122 Iowa 731, 98 N. W. 609; 2 Harvard Law Rev. 158; Machen, Corporations, sec. 1252; 7 R. C. L., sec. 320, p. 341.

⁸⁴ See People's Home Sav. Bank v. Superior Court of City and County of San Francisco, 104 Cal. 649, 38 Pac. 452, 29 L. R. A. 844, 43 Am. St. Rep. 147; State v. Tudor, 5 Day (Conn.) 329, 5 Am. Dec. 162; People v. Crossley, 69 Ill. 195; Commonwealth v. Detwiller, 131 Pa. St. 614, 18 Atl. 990, 992, 7 L. R. A. 357, 360; Harvey v. Linville Improvement Co., 118 N. C. 693, 24 S. E. 489, 32 L. R. A. 265, 54 Am. St. Rep. 749; In

re Timen, 120 N. Y. Misc. 815, 200 N. Y. Supp. 488.

A by-law providing that no proxy shall be voted by one not a stockholder is unreasonable and invalid. A stockholder may choose any person to cast his vote. People's Home Sav. Bank v. Superior Court of City and County of San Francisco, 104 Cal. 649, 38 Pac. 452, 29 L. R. A. 844, 43 Am. St. Rep. 147.

⁸⁵ State v. Tudor, 5 Day (Conn.) 329, 5 Am. Dec. 162; Commonwealth v. Detwiller, 131 Pa. St. 614, 18 Atl. 990, 992, 7 L. R. A. 357, 360; People v. Crossley, 69 Ill. 195. Contra, Taylor v. Griswold, 14 N. J. Law 222, 27 Am. Dec. 33.

⁸⁶ In re Barker, 6 Wend. (N. Y.) 509; In re Germicide Co. of New York, 65 Hun (N. Y.) 606, 20 N. Y. Supp. 495; In re Glen Salt Co., 17 N. Y. App. Div. 234, 45 N. Y. Supp. 568; In re Schwartz & Gray, 77 N. J. Law 415, 72 Atl. 70.

vote as my proxy at the annual meeting of the Stockholders of the _____ Company, to be held at the office of the corporation at _____ street, (city), (state), on the _____ day of _____ 19____, or at any adjournment thereof, according to the number of votes I should be entitled to cast if personally present at the said meeting. All previous proxies by me made are hereby revoked.

“IN WITNESS WHEREOF, I have hereunto set my hand this _____ day of _____, 19____.

Witness: _____.”

_____(L. S.)

A proxy to vote stock, to be valid, must have been given by the person who is the legal owner of the stock and entitled to vote the same at the time it is to be voted.⁸⁷ But where A, a stockholder, gave a proxy to T, and later A signed a transfer to T, which T did not register until after election day, T was entitled to vote the shares under the proxy. The vendee thus secures the right to vote by agreement with the vendor by means of a proxy, although not yet registered as a stockholder. A vendor who is still registered as a stockholder may vote by proxy.⁸⁸

A proxy to vote stock belonging to the estate of a deceased person must be given by the executor, for he is the legal owner. A provision in a will undertaking to give a proxy to vote stock belonging to the estate, or directing the executor to give a proxy to a particular person, is ineffectual, unless the proxy is given.⁸⁹ But if a will directs that one of several executors shall vote stock belonging to the estate, and that the others shall give him proxies for the purpose, they may be compelled by the court to do so.⁹⁰

A proxy to vote in the ordinary concerns of the corporation—and proxies are to be thus construed unless their terms are special—is no authority to vote for a fundamental change in or surrender of the charter of the corporation, or for a transfer of all its property to another corporation, or on other unusual questions.⁹¹ A person who has given a proxy to vote stock owned by him is represented by the proxy as agent for all purposes of the

⁸⁷ *Tunis v. Hestonville, M. & F. Passenger R. Co.*, 149 Pa. St. 70, 24 Atl. 88, 15 L. R. A. 665; *In re Mohawk & H. R. Co.*, 19 Wend. (N. Y.) 135.

⁸⁸ *Thompson v. Blaisdell*, 93 N. J. Law 31, 107 Atl. 405; *Cleveland City Ry. Co. v. First Nat. Bank of New York*, 68 Ohio St. 582, 67 N. E. 1075; *In re S. & S. Mfg. & Sales Co.*, 246 Fed. 1005. Cf. *Witham v. Cohen*, 100 Ga. 670, 28 S. E. 505.

⁸⁹ *Tunis v. Hestonville, M. & F.*

Passenger R. Co., 149 Pa. St. 70, 24 Atl. 88, 15 L. R. A. 665.

⁹⁰ *Lafferty's Estate*, 154 Pa. St. 430, 26 Atl. 388.

⁹¹ *Smith v. Smith*, 3 Desaus. (S. C.) 557; *Abbot v. American Hard Rubber Co.*, 33 Barb. (N. Y.) 578; *Shield v. Lone Star Life Ins. Co.* (Tex. Civ. App.), 202 S. W. 211. *Cp. Crook v. International Trust Co.*, 32 App. Cas. (D. C.) 490; *Rossing v. State Bank of Bode*, 181 Iowa 1013, 165 N. W. 254 (dissolution).

meeting, within the limits of the authority conferred; and it has been held, therefore, that a stockholder who has authorized another to vote his stock at any and all stockholders' meetings, "in the same manner as I should do were I there personally present," is estopped, by the vote of his proxy, as respects any irregularities in the call or proceedings of the meeting which he could have waived if personally present.⁹²

Revocation or termination of power.—One who has given a proxy or power of attorney to vote stock owned by him may revoke the same at any time, unless it is coupled with an interest, even though it may in terms be irrevocable.⁹³ Indeed, according to the weight of authority, an irrevocable proxy or power of attorney to vote stock, if not coupled with an interest, is contrary to public policy.⁹⁴ Revocation of a proxy need not be in the form or manner provided in the proxy. It may be revoked orally, or by conduct. Appearing and asserting the right to vote at a meeting revokes a proxy previously given.⁹⁵ A proxy or power of attorney to vote stock is generally irrevocable, however, if so in terms, when it is based upon a consideration, or coupled with an

⁹² *Columbia Nat. Bank v. Mathews*, 85 Fed. 934. See *McClean v. Bradley*, 282 Fed. 1011.

⁹³ *Woodruff v. Dubuque & S. C. R. Co.*, 30 Fed. 91; *Schmidt v. Mitchell*, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427; *Brown v. Pacific Mail Steamship Co.*, 5 Blatchf. 525, Fed. Cas. No. 2025; *Luthy v. Ream*, 270 Ill. 170, 110 N. E. 373, Ann. Cas. 1917 B 368.

In *Simpson v. Nielson*, — Cal. App. —, 246 Pac. 342, the court says: "The appellants rely upon a voting agreement executed June 16, 1922, wherein Neibel, one of the plaintiffs, agreed with certain of the defendants that the defendant Collopy should vote their stock at all meetings of the corporation in accordance with the wishes of the majority of the signers of the agreement. The term of the agreement was fixed at 12 years, and Collopy was named as proxy for a period of 5 years. The appellants rely upon *Smith v. San Francisco & N. P. Ry. Co.*, 115 Cal. 584, 47 Pac. 582, 35 L. R. A. 309, 56 Am. St. Rep. 119, wherein a similar agreement, except as to the time of its duration,

was held valid. After that decision, the Legislature enacted section 321b, Civil Code, which provides that no proxy for the voting of stock shall be valid unless it shall specify the length of its duration, which shall not exceed 7 years, and that all proxies for such purposes shall be revocable. There is no uncertainty or ambiguity in the section of the Code cited. A proxy given for a term in excess of 7 years is invalid, and one for any term is revocable at the pleasure of the stockholder. Cases involving voting trust agreements likewise have no application here. The parties entered into an agreement in violation of the express terms of the statute.

⁹⁴ *Post*, § 174; *Bridgers v. First Nat. Bank*, 152 N. C. 293, 67 S. E. 770, 31 L. R. A. (N. S.) 1199; *Warren v. Pim*, 66 N. J. Eq. 353, 59 Atl. 773; *Luthy v. Ream*, 270 Ill. 170, 110 N. E. 373, Ann. Cas. 1917 B 368.

⁹⁵ *Schmidt v. Mitchell*, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427; *Commonwealth v. Patterson*, 158 Pa. St. 476, 27 Atl. 998; *In re Schwartz & Gray*, 77 N. J. Law 415, 72 Atl. 70.

interest, and is not contrary to public policy, as where it is given, for the purpose of additional security, to creditors of the corporation, or to a trustee for their benefit, or is given to a person having rights under an executory contract for the sale of stock, or the like.⁹⁶

§ 174. Agreements affecting the right to vote—Voting trusts. —Voting trusts or agreements by which stockholders surrender their voting power, and place it irrevocably in the hands of others, are contrary to public policy, and illegal, according to some authorities, as the voting power is thereby placed in the hands of persons having no beneficial interest. But such agreements or trusts are legal, according to others if they are supported by a sufficient consideration, and the object is not unlawful.

It may be laid down as an undoubted general principle that any contract on the part of a stockholder or stockholders of a corporation, or between stockholders, to vote their shares in a particular way, or not to vote in a particular way, is illegal and void if the agreement contemplates a fraud upon other stockholders, or upon the creditors of the corporation.⁹⁷ As we shall presently see, it is not unlawful *per se* for stockholders to agree or combine for the election of directors or other officers, so as to secure or retain control of the corporation. But any agreement by or between a part of the stockholders of a corporation, particularly where they own a majority of the stock, by which they bind themselves to vote for certain officers or directors, or for themselves, at a stated salary, or for certain measures, without regard to what may be to the best interests of the company, or otherwise place their own interests in opposition to the interests of the company, since it tends to a perpetration of a fraud upon minority stockholders, is contrary to public policy, and illegal.⁹⁸

⁹⁶ *Mobile & O. R. Co. v. Nicholas*, 98 Ala. 92, 12 So. 723; *Hey v. Dolphin*, 92 Hun (N. Y.) 230, 36 N. Y. Supp. 627; *Smith v. San Francisco & N. P. Ry. Co.*, 115 Cal. 584, 47 Pac. 582, 35 L. R. A. 309, 56 Am. St. Rep. 119; *Boyer v. Nesbitt*, 227 Pa. 398, 76 Atl. 103, 136 Am. St. Rep. 890; *Chapman v. Bates*, 61 N. J. Eq. 658, 47 Atl. 638, 88 Am. St. Rep. 459. Cf. *Morel v. Hoge*, 130 Ga. 625, 61 S. E. 487, 16 L. R. A. (N. S.) 1136, 14 Ann. Cas. 935.

In *Chapman v. Bates*, 61 N. J. Eq. 658, 47 Atl. 638, it is held that a

proxy and power of attorney giving voting powers and the right to dispose of the stock, and by its terms irrevocable, will not be revoked in an equitable suit unless it appears that the purposes are illegal or against public policy. A pooling agreement is not necessarily illegal.

⁹⁷ *Venner v. Chicago City Ry. Co.*, 258 Ill. 523, 101 N. E. 949; *Cone v. Russell*, 48 N. J. Eq. 208, 21 Atl. 847.

⁹⁸ *Cone v. Russell*, 48 N. J. Eq. 208, 21 Atl. 847; *West v. Camden*, 135 U. S. 507, 34 L. Ed. 254, 10 Sup. Ct. 338; *Wilbur v. Stoepel*, 82 Mich.

But as the New York court has said:⁹⁹ "It is not illegal or against public policy for two or more stockholders owning the majority of shares of stock to unite upon a course of corporate policy or action, or upon the officers whom they will elect. An ordinary agreement, among a minority in number, but a majority in shares, for the purpose of obtaining control of the corporation by the election of particular persons as directors is not illegal. Shareholders have the right to combine their interests and voting powers to secure such control of the corporation, and the adoption of and adhesion by it to a specific policy and course of business." Such agreements are valid and binding if they do not contemplate any fraud, oppression or wrong against other stockholders or other illegal object.

A corporation which is not affected by control devices such as voting trusts has its management determined by the vote on the day of the annual election. Very often the control may lie with those who can obtain proxies from the nominal holders of the speculative stock, which is frequently registered in one broker's name or another's, although perhaps none of his customers then owns a single share. Control of a corporation depends upon some individual or group being able to vote a majority of the stock present in person or by proxy at the annual meeting for election of directors. Methods by which groups seek to retain control with as little expense as possible are (1) by the use of voting trusts; (2) by the use of holding companies which hold a majority of the shares of the subsidiary; (3) by classification of the stock, with the voting power vested in a small class of "banker's shares" or "management stock."¹⁰⁰

344, 46 N. W. 724, 21 Am. St. Rep. 568; *Snow v. Church*, 13 N. Y. App. Div. 108, 42 N. Y. Supp. 1072; *Cone v. Russell*, 48 N. J. Eq. 208, 21 Atl. 847; *White v. Thomas Inflatable Tire Co.*, 52 N. J. Eq. 178, 28 Atl. 75; *Noyes v. Marsh*, 123 Mass. 286; *Woodruff v. Wentworth*, 133 Mass. 309; *Guernsey v. Cook*, 120 Mass. 501; *Seitz v. Michel*, 148 Minn. 80, 181 N. W. 102, 12 A. L. R. 1060; *Manson v. Curtis*, 223 N. Y. 313, 119 N. E. 559.

⁹⁹ *Manson v. Curtis*, 223 N. Y. 313, 319, 119 N. E. 559, Ann. Cas. 1918 E 247, per Collin, J., citing *Venner v. Chicago City Ry. Co.*, 258 Ill. 523, 101 N. E. 949; *Thompson v. Thompson Carnation Co.*, 279 Ill. 54, 116 N. E.

648, Ann. Cas. 1917 E 591; *Smith v. San Francisco & N. P. Ry. Co.*, 115 Cal. 584, 47 Pac. 582, 56 Am. St. Rep. 119; *Faulds v. Yates*, 57 Ill. 416, 11 Am. Rep. 24; *Chapman v. Bates*, 61 N. J. Eq. 658, 47 Atl. 638, 88 Am. St. Rep. 459, aff'g 60 N. J. Eq. 17, 46 Atl. 591; *Hey v. Dolphin*, 92 Hun (N. Y.) 230, 36 N. Y. Supp. 627; *Williams v. Montgomery*, 68 Hun (N. Y.) 416, 22 N. Y. Supp. 1033, modified 148 N. Y. 519, 43 N. E. 57; *Ohio & M. Ry. Co. v. State*, 49 Ohio St. 668, 32 N. E. 933.

¹⁰⁰ See Nonvoting stock and banker's control, *Berle*, 39 Harvard Law Rev. 673; *Wm. Z. Ripley*, "From Main Street to Wall Street," 137 Atlantic Monthly 97 (Jan. 1926), pro-

Concentration of control is sometimes attained by a series of holding corporations piled one on top of another.^{100a} The effect of such a series, each controlling a bare majority of the stock of the one preceding it as subsidiary, is to give to the holder of a majority of the stock of the last corporation, having but a few thousand dollars capital the control of the first of the series with a capital of many millions. Professor Ripley points out that: "By resorting to the nonvoting stock device, an almost unbelievably exaggerated inverted pyramid of control would be disclosed. On top of all this you may add, if you please, that the infinitesimal fraction of controlling shares at the top may be trusted as a still further measure of protection against loss of control."^{100b}

Voting trusts and irrevocable proxies.—Whether or not stockholders may surrender their voting power, and irrevocably vest it in others, permanently or for a stated time, is a question on which there is a sharp conflict of authority.^{100c} A voting trust, stripped of nonessentials, is simply one form of pooling agreement as to voting. The object of a voting trust is to unite voting power and

testing against the use of devices by which the stockholder owners are divorced from the exercise of the right to elect directors and to influence the corporate policy, on the theory that power and responsibility should be linked with the ownership of the property.

Under New Jersey statutes it is held that common stock may be divided into classes, and the voting privilege may be withheld from any class. The issuance of nonvoting stock is not prohibited as against public policy. The mere fact that the purpose of stockholders in withholding voting power from a new issue of common stock is to perpetuate the management is no objection in the absence of bad faith, to the issue. *General Inv. Co. v. Bethlehem Steel Corp.*, 87 N. J. Eq. 234, 100 Atl. 350.

^{100a} "More Light! and Power too" *The Public and Its Utilities*, Wm. Z. Ripley, 138 Atlantic Monthly 667, 671: "First holding corporation A may control the operating company by ownership of 51 per cent of its capital stock. If thereupon corporation B controls corporation A by ownership of a like bare majority of its

common shares the investment necessary to swing the entire enterprise is again practically cut in halves, and so on." See also, Harriman, 13 Yale Law Journal 119.

^{100b} "More Light! and Power too." *The public and Its Utilities*, Wm. Z. Ripley, 138 Atlantic Monthly 667, 671.

^{100c} See Wormser, The legality of corporate voting trusts and pooling agreements, 18 Columbia Law Rev. 123; Harriman, Voting trusts and holding companies, 13 Yale Law Journal 109; Smith, Limitations on the validity of voting trusts, 22 Columbia Law Rev. 627; Tuller, 44 American Law Rev. 663; notes, 29 Harvard Law Rev. 433; 3 Virginia Law Rev. 467; Pooling agreements among stockholders, 76 Central Law Journal 245, 250. Voting trusts; their nature and validity, 40 Harvard Law Rev. 107; Tompers v. Bank of America, 217 N. Y. App. Div. 691; 217 N. Y. Supp. 67, noted in 26 Columbia Law Rev. 894. The New York statute which withdraws authority to form voting trusts from banking corporations merely prohibits voting trust agreements in the future.

assure control and continuity of the management and policy of a corporation. The general plan is as follows: Stockholders entering the pool indorse their stock to trustees. The trustees have the stock registered on the books of the company by surrendering the old certificates so indorsed and taking in return new certificates in their own names. The trustees issue trust certificates to those in the pool. Dividends are to be paid over to the certificate holder less expenses. By this arrangement the voting power is separated from the beneficial ownership of the stock.

It is clear that an agreement or power of attorney affecting the right to vote stock, or a voting trust, is contrary to public policy, and therefore illegal and void, if the purpose is fraudulent or unlawful. This is true, for instance, when the purpose is to enable a majority of the stockholders to conduct and control the business of the corporation in their own interest, or in the interest of another corporation or person, or otherwise in fraud of the rights of the minority stockholders.¹⁰¹ And even when there is no fraudulent intent, or violation of an express charter or statutory provision, an agreement by which stockholders surrender their voting power, and attempt to place it irrevocably in others, may be regarded by some as invalid. According to certain decisions it is the policy of the law that each stockholder in a corporation shall be free to cast his vote, either in person or by proxy, for what he deems the best interest of the corporation, the other stockholders being entitled to such free exercise of his judgment by each. And, therefore, any agreement, trust, pool, or other combination or device, by which any number of stockholders combine irrevocably to place the power to vote their shares, or to determine how they shall be voted, in others, who have no beneficial interest in the stock or the management of the corporation, whether permanently or for a term of years, is contrary to public policy and void, even though no actual fraud may be contemplated.¹⁰²

¹⁰¹ Shepaug Voting Trust Cases (Bostwick v. Chapman, and Starbuck v. Mercantile Trust Co.), 60 Conn. 553, 24 Atl. 32 (secret purpose of syndicate to make profit out of certain construction contracts by abuse of control of a railroad); Hafer v. New York, Lake Erie & W. R. Co., 14 Wkly. Law Bul. (Ohio) 68; Guernsey v. Cook, 120 Mass. 501; Cone v. Russell, 48 N. J. Eq. 208; White v. Thomas Inflatable Tire Co., 52 N. J.

Eq. 178, 28 Atl. 75; Gage v. Fisher, 5 N. D. 297, 65 N. W. 809, 31 L. R. A. 557; National Liberty Ins. Co. v. Bank of America, 126 N. Y. Misc. 753, 214 N. Y. Supp. 643 (the New York statute authorizing voting trusts does not validate a voting trust which contemplates an illegal object). See 25 Columbia Law Rev. 951.

¹⁰² Of the cases which condemn agreements of this character, some go to the extent of declaring them to be

This hostile view is that if the object of the voting trust is merely to transfer the control to trustees, who are given unrestricted discretion to govern the property, and its real stockholders have attempted to exclude themselves from all voice in its affairs, and where no plan, organization or reorganization is to be carried out, the arrangement is to be condemned as contrary to public policy, and invalid against the parties themselves, and perhaps even as against nonassenting stockholders.¹⁰³ It is necessary to distinguish between the right of a shareholder, not a party to a voting trust to have an injunction to restrain its operation, and the right of a party to the voting trust to withdraw from the

void *per se*, as contrary to public policy; some, on the other hand, say that they are not void *per se* but merely revocable. Some of these leading cases are: *Luthy v. Ream*, 270 Ill. 170, 110 N. E. 373, Ann. Cas. 1917 B 368; *Shepaug Voting Trust Cases*, 60 Conn. 553, 24 Atl. 32; *Warren v. Pim*, 66 N. J. Eq. 353, 59 Atl. 773; *Clowes v. Miller*, 60 N. J. Eq. 179, 47 Atl. 345; *Kreissl v. Distilling Co.*, 61 N. J. Eq. 5, 47 Atl. 471; *Morel v. Hoge*, 130 Ga. 625, 61 S. E. 487, 16 L. R. A. (N. S.) 1136, 14 Ann. Cas. 935; *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489, 32 L. R. A. 265, 54 Am. St. Rep. 749; *Bridgers v. First Nat. Bank*, 152 N. C. 293, 67 S. E. 770, 31 L. R. A. (N. S.) 1199.

In *Luthy v. Ream*, 270 Ill. 170, 110 N. E. 373, Ann. Cas. 1917 B 368, plaintiff assignee of a trust certificate sued to obtain his stock free from the trust. It was held that the power to vote is inherently attached to and inseparable from the real ownership of each share, and can only be delegated by proxy with power of revocation. Stockholders cannot deprive themselves of the power to exercise their right to vote at stockholders' meetings for the best interests of all concerned.

¹⁰³ *Bostwick v. Chapman* (*Shepaug Voting Trust Cases*), 60 Conn. 553, 24 Atl. 32. A voting trust was held illegal as against public policy. It was decreed that the stock deposited under a voting trust should be distributed by the trustee to the holders of the trust certificates. The abdication of voting power to some agent who

has no interest was contrary to the safety of the stockholder and to the duty which he owes to his fellow stockholders to act for the welfare of the corporation. He cannot strip himself of the power to perform this duty. See also, *White v. Thomas Inflatable Tire Co.*, 52 N. J. Eq. 178, 28 Atl. 75.

The North Carolina court has been the strongest exponent of the view that every stockholder must be left free to vote as he deems best for the interest of the corporation, and that any device by which the voting right is placed within the irrevocable power of another is invalid as against public policy. *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489, 32 L. R. A. 265, 54 Am. St. Rep. 749; *Sheppard v. Rockingham Power Co.*, 150 N. C. 776, 64 S. E. 894; *Bridgers v. First Nat. Bank*, 152 N. C. 293, 67 S. E. 770, 31 L. R. A. (N. S.) 1199 (injunction restraining trustees from acting under voting trust at suit of stranger to the agreement.)

An agreement which conferred upon the trustees the uncontrolled power of management of a bank for fifteen years by which the subscribing stockholders stripped themselves of their power to vote and to participate in the annual meetings of the stockholders at which directors are elected, and thereby control the policy of the bank was held invalid, although the object was to prevent the control from passing into the hands of a single stockholder who was buying up stock and paying more than its market or even book value.

agreement at his pleasure. It may be considered not to be illegal or contrary to public policy so long as the parties thereto continue to acquiesce. A decision that the assignment of voting power is revocable does not involve a decision that the trust was void or wrongful as against other stockholders.^{103a} By a 7 to 6 decision, the highest New Jersey court held in *Warren v. Pim*¹⁰⁴ that a voting trust was contrary to public policy and void. The voting trust was formed to enable foreign holders of stock of a company to control it, by a trust to continue for 50 years unless sooner closed by the trustee or three-fourths of the depositors. An injunction was granted to nonassenting stockholders to prevent the trustee from exercising the voting power on the stock. The court was much divided as to the grounds for the relief granted.

The better view toward voting trusts would seem to be that they are valid except where an improper motive or object is shown. The more hostile view is that in the absence of affirmative justification, the stockholders cannot strip themselves of the power to vote their stock. "The voting trust to protect a lender of money, the voting trust to carry out a stated policy," these would be allowed as exceptions to a general rule against separating the voting power from the beneficial ownership.¹⁰⁵

It has been asserted in a recent article that a review of the voting trust cases justifies the following proposition as a statement of the prevailing doctrine: "A separation of the voting power of stock from its real or beneficial ownership, irrevocable for a fixed period, is contrary to public policy and void unless: (1) It is coupled with, or to protect, an interest; or (2) made to carry into effect some determined plan or policy to which the

^{103a} See Tuller, 44 American Law Rev. 668, 688; *Venner v. Chicago City E. Co.*, 258 Ill. 523, 101 N. E. 949. Bill by a stockholder on behalf of himself and all other stockholders for the purpose of having a voting trust declared illegal and void, and to enjoin voting by the trustees. Held, as plaintiff was not a party to the trust agreement, he cannot complain of its terms unless his rights as a stockholder have been affected. Whether the parties thereto can withdraw is a question which does not concern him. Pooling of stock is not *per se* against public policy, if no fraud or wrong is intended.

¹⁰⁴ 66 N. J. Eq. 353, 59 Atl. 773.

¹⁰⁵ The theory has been urged by some writers and courts that power and responsibility should be linked with the substantial ownership of the property, and that policy forbids that the stockholder-owners should be utterly divorced from the exercise of the right to elect the directors and so to influence, if not determine, the corporate policy and administration. They are the ones who have the greatest stake in the honest and competent management of the business. But by various devices the power of participation by the owners in election of directors is taken away. Ripley, "From Main Street to Wall Street," 137 Atlantic Monthly 97.

voting trustee is bound; or (3) it is merely a pooling contract under which the real owners reserve the right to direct the voting trustee. This exception is limited to those states where pooling contracts are sustained."¹⁰⁶

On the other hand, some courts hold that an arrangement by which stockholders strip themselves for a time of the right to vote their stock, and vest it in others, is valid, provided the intention or purpose is not unlawful.¹⁰⁷ Thus, in order to furnish additional security to bondholders or other creditors of a corporation, who, by reason of their relation, are interested in the manner in which the business of the corporation is conducted, stockholders may surrender their voting power by an irrevocable power of attorney or agreement, and vest it either in the creditors themselves, or in a trustee for them.¹⁰⁸ Bondholders and other creditors cannot ordinarily be given the right to vote for directors, even though they have a much larger interest in the corporation than the stockholders. A by-law of a corporation empowering bondholders to vote at stockholders' meetings, and a provision of the bonds giving such right to vote, have been held void under constitutional and statutory provisions requiring directors to be elected by a majority

¹⁰⁶ Limitations on the validity of voting trusts, Marion Smith, 22 Columbia Law Rev. 626, 633. It is believed that this is an unsound and unwarranted generalization.

In some states apparently a voting trust to be irrevocable must be coupled with a beneficial interest in the stock in addition to the bare legal title, such as an option to purchase. *Boyer v. Nesbitt*, 227 Pa. 398, 76 Atl. 103, 136 Am. St. Rep. 890; *Commonwealth v. Roydhouse*, 233 Pa. 234, 82 Atl. 74. See note 60 Univ. Pennsylvania Law Rev. 660; 24 Harvard Law Rev. 51. But this doctrine should apply to a proxy rather than to a trust, which should be held irrevocable if others are concerned in it, not because the power is coupled with an interest.

¹⁰⁷ That a voting trust is binding upon the parties to it, see *Brightman v. Bates*, 175 Mass. 105, 111, 55 N. E. 809; *Thompson-Starrett Co. v. Ellis Granite Co.*, 86 Vt. 282, 289, 84 Atl. 1017; *Boyer v. Nesbitt*, 227 Pa. 398, 404, 76 Atl. 103, 136 Am. St. Rep. 890; *Bowditch v. Jackson Co.*,

76 N. H. 351, 360, 82 Atl. 1014, L. R. A. 1917 A 1174, Ann. Cas. 1913 A 366; *Winsor v. Commonwealth Coal Co.*, 63 Wash. 62, 73, 114 Pac. 908, 33 L. R. A. (N. S.) 63; *Carnegie Trust Co. v. Security Life Ins. Co.*, 111 Va. 1, 21, 68 S. E. 412, 31 L. R. A. (N. S.) 1186, 21 Ann. Cas. 1287; *Hall v. Merrill Trust Co.*, 106 Me. 465, 76 Atl. 926, 138 Am. St. Rep. 355; *Ecker v. Kentucky Refining Co.*, 144 Ky. 264, 272, 138 S. W. 264.

"A voting trust under which corporate stock was deposited with trustee, who was given full right to vote such stock and exercise rights of owner, was binding on the parties thereto." *Bullivant v. First Nat. Bank*, 246 Mass. 324, 141 N. E. 41.

¹⁰⁸ *Mobile & Ohio R. Co. v. Nicholas*, 98 Ala. 92, 12 So. 723; *Clark v. Foster*, 98 Wash. 241, 167 Pac. 908, 909. Voting trust created by majority in good faith to induce a loan to a corporation, to continue 20 years unless the preferred stock is all redeemed and the bonded indebtedness paid prior thereto, is valid.

in value of stock.¹⁰⁹ If a corporation finds it necessary to borrow money on bonds issued for a long term of years, cannot the stockholders, consistently with public policy, in order to secure the loan, vest the voting power and management in hands satisfactory to the lenders and for a term equal to that of the loan?

In case of reorganization of a bankrupt corporation, a voting trust is frequently used to protect the bondholders by putting the control in the hands of responsible trustees. The interest of the creditors may represent the major actual investment in the corporate property, while the interest of the stockholders may represent "merely the shadow of an equity of unsubstantial value." The stock may be quoted at a low figure and held by speculators and stockbrokers with little permanent interest in the welfare of the corporation. Yet by the voting power of the stock, these stockholders exercise absolute control over the property, and it is possible for this control of the company to be bought and sold from day to day, rendering its policy subject to change. By means of a voting trust all intested as creditors and stockholders may be represented by the trustees and protected.¹¹⁰

¹⁰⁹ *Durkee v. People ex rel. Askren*, 155 Ill. 354, 40 N. E. 626, 46 Am. St. Rep. 340.

¹¹⁰ *Dewing*, Financial Policy of Corporations 151; *Mackin v. Nicollet Hotel Co.*, 10 Fed. (2d) 375.

In *Mackin v. Nicollet Hotel Co.*, 10 Fed. (2d) 375, Sanborn, J., says (in holding a voting trust valid): "Can a court of equity set aside a voting trust agreement pursuant to which common stockholders of a corporation assign their stock to trustees for a certain period of time as an inducement to and for the benefit of those who become the preferred stock holders and bondholders of the corporation?"

"The purpose of the trust agreement is obvious. It is to provide for continuity of capable management for a period of years as a protection to those whose money built this hotel. The bondholders and preferred stock holders are the ones who made the enterprise possible. The common stock holders have the speculative interest in it. The total issued common stock, assuming that it was worth

par, represents an investment of cash or property of \$450,000, as against a \$3,000,000 investment on the part of others. No improper motives can be imputed to those who were to sell their customers these securities in wanting to have the common stock trustee, so that it might not fall into the hands of persons who would either so use it as to force those who had the larger investment to take it off their hands at their price, or who might not be capable of securing competent persons to operate the hotel.

"In a situation such as is involved in this case, the beneficial interest in the stock is a speculative one. The holders of it have what amounts to a mere equity in the property or enterprise. At the outset the voting power of the stock is the thing of value, and any one loaning money to a corporation such as this, in order to be secure, must know where that voting power is to lie for a period of time sufficiently long to assure him of the repayment of the money which he has invested."

The following are the principal objections which have been urged against voting trusts in various cases, most of which, however, can be answered:

(1) That a voting trust is nothing more than a proxy and the "trustees" are in fact only agents. Statutes often limit the duration of a proxy.

(2) That it involves a divorce of the voting power from the beneficial ownership of the stock, which it was intended to protect.

(3) That it is a breach of duty toward the other stockholders to abdicate the power of exercising personal judgment and casting one's votes for the benefit of all.

(4) That it is contrary to public policy to place the control of corporations in the hands of those without direct pecuniary interest, to permit the directors to be chosen by substitute voters in place of the stockholders.

(5) That the majority may be subjected to the control of the minority, contrary to the basic idea of corporate management.

(6) That the power of the trustees may be used oppressively or fraudulently.

It is accordingly argued and held by some courts that non-assenting stockholders are entitled to relief against the exercise of control by voting trusts and that assenting persons, who are parties to such an arrangement, are under duty to withdraw both because it is against public policy and also a fraud upon nonassenting shareholders.¹¹¹ The answers which are made to the objections urged against voting trusts and agreements to pool stock are that the power of control so delegated is not often abused, in fact, that responsibility is more specifically located in voting trustees than in scattered stockholders; that harmonious administration and well-considered policies are thereby maintained, and the confidence of creditors and investors is gained; that contests for control by rival organizations and speculators are avoided; that the trustees take more pains and interest in the selection of competent directors than the stockholders. The idea that it is the duty of the stockholder which he owes to every other stockholder to exercise his voting power in the corporation to promote the general welfare, or that stockholders have the right to the personal judgment of their fellows in the selection of directors, would seem to be entirely visionary and unfounded.¹¹² Such also is the idea that

¹¹¹ See *Warren v. Pim*, 66 N. J. Eq. 353, 59 Atl. 773, per Pitney, J.

¹¹² See *Tuller*, Voting trust agreements, 44 American Law Rev. 663.

trustees having the bare legal title with no adequate personal interest in the corporate venture will neglect the responsibility of voting more than stockholders. In large corporations the privilege of voting is of little practical consequence. Few of the stockholders look into the affairs of their companies or come to the annual meetings to vote for directors. The directors and officers perpetuate their control by getting proxies. A voting trust focuses the responsibility as well as the voting power in three or five men whose control is a matter of agreement and public knowledge.¹¹³

Some practical points to be observed in drafting such an arrangement in order to safeguard its validity are as follows: (1) The purpose should appear to be for the benefit of the corporation and the whole body of stockholders; (2) the trustees should be selected from among the stockholders; (3) the substitution and appointment of new trustees for the original trustees should be provided for; (4) the agreement should recite valuable consideration other than mutual promises; (5) the arrangement should be open to any stockholders who wish to join in and deposit their stock; (6) the duration should be reasonable.¹¹⁴

III. POWERS OF THE STOCKHOLDERS.

§ 175. Power of the majority in the management and control of a corporation—In general.—The general rule is that the majority have the power to control and bind the minority, by vote at a legal meeting, in any matter which is within the powers conferred upon the stockholders, provided they act in good faith, and in the interest of the corporation; but it is otherwise if the majority exceed the powers conferred upon the corporation, or if they act fraudulently or oppressively, or if they use their control to obtain unfair advantages at the expense of the interests of the minority.

It is generally held that a stockholder is under no fiduciary relations either to the company or to his fellow stockholders, and he may vote his holdings in spite of an adverse interest in any way he deems most advantageous to himself. *United States Steel Corporation v. Hodge*, 64 N. J. Eq. 807, 54 Atl. 1, 60 L. R. A. 742.

A stockholder is not disqualified from voting on the ground that he bought his stock with the money of rival companies, and intends to use

his legal rights as holder of a majority of the stock for purposes detrimental to the interests of the corporation. If the directors elected by him attempt the illegal and improper control of the property or business in junction or redress may be had against them. *Camden & A. R. Co. v. Elkins*, 37 N. J. Eq. 273.

¹¹³ Dewing, *Financial policy of corporations*, pp. 146, 151.

¹¹⁴ See H. A. Cushing, *Voting Trusts*.

Every person who subscribes for or otherwise acquires shares in a corporation impliedly agrees that, upon any matter which comes within the powers expressly or impliedly conferred upon the stockholders, he will be bound by the will of the majority, so long as they act in good faith and according to law.¹¹⁵ The majority of the stockholders must act in good faith and in the interest of the corporation. They cannot manage the corporation fraudulently for their own interest or profit, to the exclusion of other stockholders. If they attempt to do this, even though the particular act done may not be beyond the powers conferred upon the corporation by its charter, they may be enjoined or compelled to account at the suit of other stockholders.¹¹⁶

The doctrine that the majority of the stockholders may bind the minority is also subject to the qualification that they cannot impair or violate contract rights. They cannot violate the rights secured to the minority stockholders by their contract of membership,—as by forcing them into a different enterprise, not contemplated by the minority when they became stockholders, even though there may be a statute, passed since they became stockholders, purporting to authorize the corporation to engage in such enterprise.¹¹⁷

¹¹⁵ *Foss v. Harbottle*, 2 Hare 461; *Durfee v. Old Colony & Fall River R. Co.*, 5 Allen (Mass.) 230; *Dudley v. Kentucky High School*, 9 Bush (Ky.) 576; *Enterprise Prtg. & Pub. Co. v. Craig*, 195 Ind. 302, 144 N. E. 542, 145 N. E. 309 (“one who buys stock in a corporation takes it subject to the right of the majority stockholders to elect the officers and control the company and its property”); *Cowell v. McMillin*, 177 Fed. 25, 43 (ownership of a majority of the capital stock of a corporation gives to the holders legal power to control the corporation, lay down its policies, make themselves or those whom they select, its directors or agents, and fix their compensation); *Jesup v. Illinois Cent. R. Co.*, 43 Fed. 483. See also, *Respass v. Rex Spinning Co.*, 191 N. C. 809, 133 S. E. 391.

¹¹⁶ *Atwool v. Merryweather*, L. R. 5 Eq. 464, note; *Menier v. Hooper's Telegraph Works*, 9 Ch. App. 350; *Farmers' Loan & Trust Co. v. New York & Northern Ry. Co.*, 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689; *Bjorngaard v.*

Goodhue County Bank, 49 Minn. 483, 52 N. W. 48; *Chicago Hanson Cab Co. v. Yerkes*, 141 Ill. 320, 30 N. E. 667, 33 Am. St. Rep. 315. And see post, § 190.

¹¹⁷ *Natusch v. Irving, Gow, Partnership*, Appendix vi., p. 398, 30 Harvard Law Rev. 348, 350; *Stevens v. Rutland & Burlington R. Co.*, 29 Vt. 545; *Ashton v. Burbank*, 2 Dill. 435, Fed. Cas. No. 582; *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617. See *infra*; this section, as to acceptance of Amendments of charters.

In *Natusch v. Irving*, *supra*, a minority shareholder was allowed an injunction against an unincorporated company formed to carry on fire and life insurance from undertaking to carry on the additional business of marine insurance. “The plaintiff had consented to participate in that defined venture,—he had not consented to participate in any ventures that the majority might determine. He could not be embarked upon a strange venture.” *Warren*, 30 Harvard Law Rev. 351.

Powers of stockholders.—If the charter of a corporation vests the exercise of the corporate powers generally in the board of directors or trustees, and not in the stockholders, their power extends to the purchase and the alienation or incumbrance of the corporate property, the making of contracts, the execution of bonds or other obligations of the corporation, and to every other corporate power relating to the ordinary business of the corporation, and no such power can be exercised by, or under authority from, the stockholders.¹¹⁸ But it does not vest *all* the corporate powers in the directors. Extraordinary and unusual powers, not relating to the ordinary business and affairs of the corporation, remain in the stockholders as a body, and not only may, but must, be exercised by them. Thus, notwithstanding a delegation of authority to the board of directors to manage the business of the corporation, it is for the stockholders, and not for the directors, to increase the capital stock of the corporation under legislative authority, unless such power is expressly vested in the directors,¹¹⁹ to make by-laws for the government of the corporation,¹²⁰ to make or authorize a conveyance, transfer, or lease of all the property of the corporation, when within the powers of the corporation, and thereby terminate, finally or temporarily, the business of the corporation,¹²¹ to accept amendments of the charter in certain cases,¹²² to elect directors,¹²³ to dissolve the corporation or surrender the corporate franchises,¹²⁴ or to authorize the directors to renew or

¹¹⁸ *Manson v. Curtis*, 223 N. Y. 313, 323, 119 N. E. 559, Ann. Cas. 1918 E 247; *McCullough v. Moss*, 5 Denio (N. Y.) 567; *Conro v. Port Henry Iron Co.*, 12 Barb. (N. Y.) 27; *Gashwiler v. Willis*, 33 Cal. 11, 91 Am. Dec. 607; *Colorado Springs Co. v. American Pub. Co.*, 97 Fed. 843; *Jackson v. Hooper*, 76 N. J. Eq. 592, 75 Atl. 568, 27 L. R. A. (N. S.) 658; *Lamb v. Lehman*, 110 Ohio St. 59, 143 N. E. 276. Compare powers of directors and stockholders, ante, §§ 97, 98, 99.

¹¹⁹ *Metropolitan El. Ry. Co. v. Manhattan Ry. Co.*, 11 Daly (N. Y.) 373, 14 Abb. N. C. 103; *Morton Gravel Road Co. v. Wysong*, 51 Ind. 4; *Chicago City Ry. Co. v. Allerton*, 18 Wall. (U. S.) 233, 21 L. Ed. 902.

Power conferred on directors to perform all corporate acts refers to ordinary business transactions; charter power to increase capital stock can be exercised only by stockholders.

¹²⁰ *Morton Gravel Road Co. v. Wysong*, 51 Ind. 4. See post, § 178.

¹²¹ *Metropolitan El. Ry. Co. v. Manhattan Ry. Co.*, 11 Daly (N. Y.) 373, 14 Abb. N. C. 103; *Abbot v. American Hard Rubber Co.*, 33 Barb. (N. Y.) 578; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Middlesex R. Co. v. Boston & C. R. Co.*, 115 Mass. 347. See post, § 177.

¹²² *Marlborough Mfg. Co. v. Smith*, 2 Conn. 579; *In re Newark Library Ass'n*, 64 N. J. Law, 217; *Baker's Appeal*, 108 Pa. St. 510, 1 Atl. 78, 56 Am. Rep. 231; *Alexander v. Atlanta & W. P. R. Co.*, 108 Ga. 151, 33 S. E. 866. See post, § 282, 283.

¹²³ *Mottu v. Primrose*, 23 Md. 482; *State v. Merchant*, 37 Ohio St. 251.

¹²⁴ *Smith v. Smith*, 3 Desaus. (S. C.) 557; *Pringle v. Eltringham Const. Co.*, 49 La. Ann. 301, 21 So. 515; *Forrester v. Butte & M. Consol. Copper & Silver Min. Co.*, 21 Mont.

extend the period of corporate existence. The privilege of renewal may be exercised by a majority, and the rule that fundamental changes require unanimous consent does not apply to changes authorized by the charter or by statutes in force at the time of incorporation.^{124a}

§ 176. Power of stockholders individually.—As a rule, the stockholders or members of a corporation do not represent it, and have no more power to act for or bind it than mere strangers, except when they act collectively as the corporation, and at a meeting legally called and conducted. But under some circumstances their individual acts may be given effect in equity, and even at law, as the acts of the corporation. Stockholders, individually, are not the agents of the corporation.

Stockholders of a corporation, although they may own a majority of its stock, or even all of its stock, have no power to act for the corporation, and bind it as individuals, unless they act as its duly-authorized agents. They are not its agents merely because they are stockholders, and as a rule it is not bound by their acts as individual stockholders. Thus, the stockholders of a corporation, as individuals, have no power to convey or mortgage the property of the corporation. A conveyance or mortgage by them as individuals, even though all may join, is not binding upon the corporation at law.¹²⁵ But under some authorities a conveyance or mortgage by all the stockholders may be given effect at least as against those with notice. While the majority cannot take away the right of the minority to the exercise by the directors of their discretion and power in management, yet if the real parties in interest unanimously agree on certain corporate acts, their voice should control, and even informal action by all the stockholders may bind the corporation.¹²⁶

544, 55 Pac. 229, 353. See post, § 177.

^{124a} McKemie v. Eady-Baker Grocery Co., 146 Ga. 753, 92 S. E. 282, noted 27 Yale Law Journal 422.

¹²⁵ Wheelock v. Moulton, 15 Vt. 519; Parker v. Bethel Hotel Co., 96 Tenn. 252, 34 S. W. 209, 31 L. R. A. 706; Humphreys v. McKissock, 140 U. S. 304, 35 L. Ed. 473, 11 Sup. Ct. 779; Rough v. Breitung, 117 Mich. 48, 75 N. W. 147; Sellers v. Greer, 172 Ill. 549, 50 N. E. 246, 40 L. R. A. 589. But see ante, § 99. See also,

Fletcher, Corporations, secs. 26, 1726, 1727.

¹²⁶ Bundy v. Ophir Iron Co., 38 Ohio St. 300; Swift v. Smith, 65 Md. 428, 5 Atl. 534, 57 Am. Rep. 336; First Nat. Bank of Gadsden v. Winchester, 119 Ala. 168, 24 So. 351, 72 Am. St. Rep. 904; Kentucky Coal Lands Co. v. Mineral Development Co., 295 Fed. 255; Sudduth v. Storm King Coal Co., 268 Fed. 433; Computing Scale Co. v. Toledo Computing Scale Co., 279 Fed. 648, 674. See notes, 15 Michigan Law Rev. 264; 11

As was shown in a former chapter, the distinction between a corporation as a legal entity and its stockholders or members, and the doctrine that the acts of the stockholders or members as individuals are not the acts of the corporation, is based upon a legal privilege, and the privilege of separation of capacities will be disregarded, both at law and in equity, when urged for a purpose which is not legitimate. For this reason, there may be circumstances under which the act of all the members or stockholders of a corporation will be regarded as the act of the corporation.¹²⁷

§ 177. Alienation of property and winding up of corporation.

Whether or not a majority of the stockholders of a corporation have the power to dissolve the corporation with the consent of the state, or to dispose of all its property, wind up its affairs, and abandon the enterprise, depends upon the circumstances. If a corporation is a purely private corporation, organized exclusively for pecuniary profit, as in the case of a manufacturing or trading corporation, a majority of the stockholders, acting in good faith, may, against the dissent of the minority, abandon the enterprise, sell out the property of the corporation for the purpose of paying debts, and distributing any balance of assets among the stockholders, and thus wind up its business, or dissolve under legislative authority, if the conditions are such that the business can no longer be carried on profitably.¹²⁸

This only applies, however, where the conditions have become such that the corporation cannot profitably continue the business. If the exigencies of its business are not such as to require a winding up, every stockholder has a right to insist that the enterprise shall continue for the period contemplated when the corporation was created, and a majority of the stockholders cannot arbitrarily abandon the enterprise and sell out the corporate property against

Cornell Law Quarterly 82; Ann. Cas. 1912 C 300n. And see ante, § 99.

¹²⁷ See ante, § 6.

¹²⁸ *Geddes v. Anaconda Copper Min. Co.*, 254 U. S. 590, 65 L. Ed. 425, 41 Sup. Ct. 209; *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.) 393, 66 Am. Dec. 490; *Sewell v. East Cape May Beach Co.*, 50 N. J. Eq. 717, 25 Atl. 929; *Pringle v. Eltringham Const. Co.*, 49 La. Ann. 301, 21 So. 515; *Price v. Holcomb*, 89 Iowa

123, 56 N. W. 407; *Hodges v. New England Screw Co.*, 1 R. I. 347, 53 Am. Dec. 624; *Peabody v. Westerly Water Works*, 20 R. I. 176, 37 Atl. 807; *Phillips v. Providence Steam Engine Co.*, 21 R. I. 302, 43 Atl. 598, 45 L. R. A. 560; *Bartholomew v. Derby Rubber Co.*, 69 Conn. 521, 38 Atl. 45, 61 Am. St. Rep. 57. See, *Dupee v. Boston Water Power Co.*, 114 Mass. 37. See also, 30 Yale Law Journal 633, 34 Harvard Law Rev. 787.

the dissent of the minority.¹²⁹ It is said that there is an implied contract among the stockholders to pursue the business for which the corporation was organized, and that barring business disaster, there shall be no voluntary dissolution or discontinuance except by unanimous consent. It has been contended, on the other hand, that the supposed doctrine that the members are to be deemed to have agreed that the corporate enterprise should be continued forever, or until disaster approaches, finds no support in public policy, or in the common law, or in business sense. Professor Warren puts this case:¹³⁰ "A corporation, X, has sufficient liquid assets to meet its obligations as they mature, and is making large net profits. An offer is made by Y to purchase its assets. The directors, and the holders of a large majority of its stock, vote to accept the offer. Should a court, in a suit by a minority stockholder, enjoin the proposed transfer of assets? It is submitted that the holders of a majority of the stock of a corporation organized for profit have the power to cause a transfer of all the corporate assets and a distribution of the proceeds (after satisfying creditors) to the stockholders whenever, for legitimate business reasons, they deem such a course wise. Financial embarrassment is not the only legitimate business reason for such a transfer."

There is some question as to the method of such a sale, whether or not it must be a public one, and whether the minority stockholder is entitled to receive in cash his proportion of the price paid for corporate assets rather than stock or other property.^{130a}

¹²⁹ Kean v. Johnson, 9 N. J. Eq. 401; Elyton Land Co. v. Dowdell, 113 Ala. 177, 20 So. 981, 59 Am. St. Rep. 105; People v. Ballard, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; Abbot v. American Hard Rubber Co., 33 Barb. (N. Y.) 578; Eldred v. American Palace-Car Co., 96 Fed. 59; Small v. Minneapolis Electro-Matrix Co., 45 Minn. 264, 47 N. W. 797; Dow v. Northern R. Co., 67 N. H. 1, 36 Atl. 510; Forrester v. Butte & M. Consol. Copper & Silver Min. Co., 21 Mont. 544, 55 Pac. 229, 353; Barton v. Enterprise Loan & Building Ass'n, 114 Ind. 226, 16 N. E. 486, 5 Am. St. Rep. 608; Wortman v. Luna Park Amusement Co., 61 Mont. 89, 201 Pac. 570; Allen v. Francisco Sugar Co., 92 N. J. Eq. 431, 433, 434, 112 Atl. 887; Theis v. Spokane Falls Gas Light Co., 34 Wash. 23, 74 Pac.

1004; Cook, Corporations, sec. 671; 10 Amer. Bar. Ass'n Journal 782.

¹³⁰ Voluntary transfers of corporate undertakings, E. H. Warren, 30 Harvard Law Rev. 335, 358; Beidenkopf v. Des Moines Life Ins. Co., 160 Iowa 629, 142 N. W. 434, 46 L. R. A. (N. S.) 290; Bowditch v. Jackson Co., 76 N. H. 351, 355, 82 Atl. 1014, L. R. A. 1917 A 1174, Ann. Cas. 1913 A 366; Cohen v. Big Stone Gap Iron Co., 111 Va. 468, 69 S. E. 359, Ann. Cas. 1912 A 203; Maxler v. Freeport Bank, 275 Pa. 510, 119 Atl. 592. See Cook, Corporations (8th Ed.), sec. 671.

^{130a} E. H. Warren, Voluntary transfers of corporate undertakings, 30 Harvard Law Rev. 335-336: "It is common experience that sales at public auction are usually not so advantageous to the seller as private

When a corporation has the power to dispose of all its property and abandon its business, in accordance with the principles above stated, it may dispose of its property to another corporation for stock in the latter to be disposed of for the purpose of paying the stockholders in cash, or to be distributed among its stockholders if all consent.¹³¹ But a majority of the stockholders cannot exchange the property of the corporation for stock in another corporation, to be held by the corporation, or to be distributed among the stockholders in payment of their shares, unless all the stockholders do consent.¹³² It cannot compel a dissenting stockholder to accept shares in the other company. If he insists upon it, he is entitled to have the property sold for cash, and to the payment of his share, or else to payment of the value of his interest, and he is entitled to an injunction until his rights are secured, or, if the sale has been made, he may sue to set it aside unless he is estopped.¹³³

No majority of the stockholders, however large, has power, unless it is expressly conferred by the legislature, to sell and transfer

sales. The majority of the stockholders should not be stripped of the power of making a private sale. . . . If a minority stockholder questions the propriety of a private sale the court must inquire whether the price is a fair one, whether there is so great a chance that the property will bring more at a public sale than at this private sale that it should not abide by the judgment of the minority as to the mode of sale."

¹³¹ *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.) 393, 66 Am. Dec. 490; *Hodges v. New England Screw Co.*, 1 R. I. 347, 53 Am. Dec. 624.

¹³² *Lauman v. Lebanon Val. R. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; *Frothingham v. Barney*, 6 Hun (N. Y.) 366; *Taylor v. Earle*, 8 Hun (N. Y.) 1; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Elyton Land Co. v. Dowdell*, 113 Ala. 177, 20 So. 981, 59 Am. St. Rep. 105 (corporation could not have sold for cash, because the concern was prosperous); *Morris v. Elyton Land Co.*, 125 Ala. 263, 28 So. 513.

But it has been held that the corporation can sell for stock under the same circumstances that they can sell for cash. *Metcalf v. American School Furn. Co.*, 122 Fed. 115; *Bowditch v. Jackson Co.*, 76 N. H.

351, 82 Atl. 1014, L. R. A. 1917 A 1174, Ann. Cas. 1913 A 366. Compare *Forsyth v. Alabama City G. & A. R. Co.*, 207 Ala. 488, 93 So. 401 (statute, four-fifths in value of stock).

¹³³ *Lauman v. Lebanon Val. R. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; *Elyton Land Co. v. Dowdell*, 113 Ala. 177, 20 So. 981, 59 Am. St. Rep. 105; *Winfree v. Riverside Cotton Mills*, 113 Va. 717, 75 S. E. 309. Contra, *Mayfield v. Alton Ry., Gas & Electric Co.*, 198 Ill. 528, 65 N. E. 100. See *Butler v. New Keystone Copper Co.*, 10 Del. Ch. 371, 93 Atl. 380; *Jackson v. Gardiner Co.*, 217 Fed. 350; *Mason v. Pewabic Min. Co.*, 133 U. S. 50, 33 L. Ed. 524, 10 Sup. Ct. 224.

It has been held that where stock is listed on the New York Stock Exchange and enjoys a ready market so that it is the equivalent of cash, corporate property may be sold for stock where the circumstances warrant a sale. *Geddes v. Anaconda Copper Min. Co.*, 254 U. S. 590, 65 L. Ed. 425, 41 Sup. Ct. 209. See 33 Yale Law Journal, 633, where it is pointed out that the right of dissenting stockholders to cash does not affect the power of the corporation to sell for stock.

all of its property to another corporation for stock in the latter, where the purpose is, not to wind up its business and distribute the stock among its shareholders, but to continue its existence as a corporation and hold the stock itself, or, in other words, where the object is to continue corporate life and activity through the instrumentality of the other corporation.¹³⁴ A majority of the stockholders of a purely private corporation may lease all its property to another corporation when the exigencies of its business require such a lease,¹³⁵ but not otherwise.¹³⁶

By statute it is frequently provided that a corporation may, with the consent of two-thirds of its stock, or some other majority, sell and convey its property rights.¹³⁷ The discretionary power of the majority, conferred by statute, may extend to a transaction which will result in a practical merger or consolidation by the purchase of the property by another corporation.¹³⁸ But it has been held that if the majority stockholders use their statutory power to impose their will upon the minority, they assume a fiduciary relationship, and if they abuse their power to advantage themselves at the expense of the minority their conduct is fraudulent and relief may be had in equity.¹³⁹ Sometimes the statutes

¹³⁴ *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787, 31 L. R. A. 415; *Byrne v. Schuyler Elec. Mfg. Co.*, 65 Conn. 336, 31 Atl. 838, 28 L. R. A. 304; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Murrin v. Archbald Consol. Coal Co.*, 232 N. Y. 541, 134 N. E. 563; *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818, L. R. A. 1915 D 632; *Schwab v. Potter Co.*, 194 N. Y. 409, 87 N. E. 670; *Riker & Son v. United Drug Co.*, 79 N. J. Eq. 580, 82 Atl. 930, Ann. Cas. 1913 A 1190. See Warren, Voluntary transfers of corporate undertakings, 30 Harvard Law Rev. 355.

¹³⁵ *Featherstonhaugh v. Lee Moor Porcelain Clay Co.*, L. R. 1 Eq. 318; *Bartholomew v. Derby Rubber Co.*, 69 Conn. 521, 61 Am. St. Rep. 57; *Plant v. Macon Oil & Ice Co.*, 103 Ga. 666, 30 S. E. 567.

¹³⁶ *Small v. Minneapolis Electro-Matrix Co.*, 45 Minn. 264, 47 N. W. 797; *Copeland v. Citizens' Gas Light Co.*, 61 Barb. (N. Y.) 60; *Dow v. Northern R. R.*, 67 N. H. 1, 36 Atl. 510; *Allen v. Francisco Sugar Co.*, 92 N. J. Eq. 391, 431, 110 Atl. 37.

¹³⁷ *In re Bickerton*, 232 N. Y. 1,

133 N. E. 41, it is said this statute was enacted to meet the rule of *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737, that a corporation could not sell all or an essential part of its property or its business. This resulted in injustice to the majority in want of power to sell the business on terms deemed advantageous, and gave the dissenting minority power to compel the majority to buy them out on their own terms in order to secure unanimous consent. See *V Halsbury's Laws of England*, pp. 584, 589; *Cook, Corporations*, sec. 671.

¹³⁸ *J. H. Lane & Co. v. Maple Cotton Mills*, 226 Fed. 692, 696.

¹³⁹ *Southern Pac. Co. v. Bogert*, 250 U. S. 483, 492, 63 L. Ed. 1099, 39 Sup. Ct. 533: "It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation." Majority stockholders exercising control through a subsidiary are deemed trustees for the minority, and under duty to make distribution of the fruits of control on equal terms.

give the dissenting minority the right to demand the value of their stock in cash.¹⁴⁰

Fiduciary relation of majority.—There is no rule which prevents a stockholder from voting in his own interest to ratify a voidable contract, or from contracting with the corporation or purchasing its property.^{140a} But the majority cannot use their voting power to authorize or ratify acts of officers or agents by which they appropriate corporate assets at the expense of the minority. In many cases it is said that the majority sustain a fiduciary relation to the corporation and the minority in their dealings with the corporation and the exercise of their controlling power.¹⁴¹ If the owners of a majority of the stock of a corpora-

Allied Chemical & Dye Corp. v. Steel & Tube Co. of America, 14 Del. Ch. 1, 120 Atl. 486, 491; 33 Yale Law Journal 436: "The court follows the prevalent and sound view that while gross inadequacy of price will be considered a badge of fraud, mere inadequacy standing alone and capable of being construed as an honest exercise of sound judgment will not be a sufficient basis to set aside the sale." *Op. Wheeler v. Abilene Nat. Bank*, 159 Fed. 391, 16 L. R. A. (N. S.) 892 n.

¹⁴⁰ *In re Bickerton*, 232 N. Y. 1, 133 N. E. 41, dismissing appeal, 196 N. Y. App. Div. 231, 187 N. Y. Supp. 267. Under New York Stock Corporation Law (1909), sec. 17, nonconsenting stockholders who object to the sale within 20 days may demand payment for their stock and have three appraisers appointed by the court. The statute was enacted to enable the majority to sell if that was deemed the best policy, and at the same time protect the minority if they regarded the sale as opposed to their interests. See 27 Columbia Law Rev. 547.

^{140a} *N. W. Transportation Co. v. Beatty*, 12 App. Cas. 589 [1880]. Every shareholder has a right to vote upon any question such as ratifying a voidable contract with himself, even though he is director and has an adverse personal interest. The contract was not oppressive or fraudulent. Cited and distinguished in *Rogers v. Nashville, C. & St. L. R. Co.*, 91 Fed. 299. See *Gamble v. Queens County Water Co.*, 123 N. Y. 91,

25 N. E. 201, 9 L. R. A. 527; *Du Pont v. Du Pont*, 251 Fed. 937, 944.

¹⁴¹ There is a growing tendency to hold that the majority stockholders of a corporation stand in a fiduciary relation to the minority. *Farmers' Loan & Trust Co. v. New York & N. R. Co.*, 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689; *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320, 30 N. E. 667, 33 Am. St. Rep. 315. This means that they should not dishonestly exercise the legal power which they have to secure an advantage to themselves over the minority. *Bowditch v. Jackson Co.*, 76 N. H. 351, 82 Atl. 1014, L. R. A. 1917 A 1174, Ann. Cas. 1913 A 366; *Hyams v. Calumet & Hecla Min. Co.*, 221 Fed. 529, 537; *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N. Y. 185, 195, 123 N. E. 148; *Heffern Co-Op. Consol. Gold Min. & Mill. Co. v. Gauthier*, 22 Ariz. 67, 193 Pac. 1021; *Southern Pac. Co. v. Bogert*, 250 U. S. 483, 487, 63 L. Ed. 1099, 39 Sup. Ct. 533 ("The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors"); *Wheeler v. Abilene Nat. Bank Bldg. Co.*, 159 Fed. 391, 16 L. R. A. (N. S.) 892 n, 14 Ann. Cas. 917 (sale of corporate property by single holder of majority stock for its fair value, but for less than could have been obtained for it, is voidable at election of minority.) See *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 25 N. E.

tion take advantage of their position, and of their influence over the directors or other officers, to obtain an inequitable contract, conveyance, or lease with or from the corporation, they perpetrate a fraud upon the minority, and the contract, lease, or conveyance will be set aside in equity at the suit of dissenting stockholders.¹⁴² A violation of duty by the directors cannot be ratified by the action or votes of those who were guilty of participation in the wrongful acts, even though they constitute a majority of the stockholders.¹⁴³ There is a conflict of authority whether the power to dissolve a corporation given by statute to a specified majority is absolute, or whether it is limited to honest motives,

201, 9 L. R. A. 527; *Hodgman v. Atlantic Refining Co.*, 300 Fed. 590 (majority stockholders cannot ratify their own or other's fraud upon the minority.) See also, *Berle, Nonvoting stock and bankers' control*, 39 *Harvard Law Rev.* 673, 681, 687.

¹⁴² *Chicago Hanson Cab Co. v. Yerkes*, 141 Ill. 320, 30 N. E. 667, 33 Am. St. Rep. 315; *Russell v. Rock Run Fuel-Gas Co.*, 184 Pa. St. 102, 39 Atl. 21; *Davis v. Memphis City R. Co.*, 22 Fed. 883; *Rogers v. Nashville, C. & St. L. Ry. Co.*, 91 Fed. 299; *Pearson v. Concord R. Corp.*, 62 N. H. 537, 13 Am. St. Rep. 590; *George v. Central Railroad & Banking Co.*, 101 Ala. 607, 14 So. 752.

In *Chicago Hanson Cab Co. v. Yerkes*, supra, corporation was about to wind up because unprofitable; all its stock, except that of Yerkes, was purchased quietly by Needham, director and secretary, acting with Springer, but it still stood in old names in part at least. Stockholders' meeting then voted to authorize Pullman president (who still had stock but under option to N) and N secretary to sell or mortgage property at their discretion. Yerkes voted contra. Under this authority, property was sold to N and Springer who was acting with N. This sale was approved by stockholders' meeting, Yerkes voting contra. On bill to set aside the sale, held: Yerkes is entitled to an injunction restraining sale, decree setting it aside as void, and appointment of a receiver. Majority could not ratify sale to themselves. See *Nowak v. National Car*

Coupler Co., 260 Ill. 260, 103 N. E. 222.

Heim v. Jobes, 14 Fed. (2d) 29, 32: "Where the contract is unfair or unconscionable, where the consideration is inadequate, or where the contract is not for the best interests of the corporation but subserves the selfish purpose of such stockholder, it will set aside such contract at the instance of the corporation or its minority stockholders. *Mumford v. Ecuador Development Co.*, 111 Fed. 639, 643; *Meeker v. Winthrop Iron Co.*, 17 Fed. 48, 50, 51; *Ervin v. Oregon Ry. & Nav. Co.*, 20 Fed. 577, 579, 580; *Id.*, 27 Fed. 625, 632; *Rogers v. Nashville, C. & St. L. Ry. Co.*, 91 Fed. 299, 311-314; *Rothchild v. Memphis & C. R. Co.*, 113 Fed. 476, 479-481; *Stebbins v. Michigan Wheelbarrow & Truck Co.*, 212 Fed. 19, 28; *Pennsylvania Canal Co. v. Brown*, 235 Fed. 669, 684; *Hyams v. Calumet & Hecla Min. Co.*, 221 Fed. 529, 537; *Jones v. Missouri-Edison Elec. Co.*, 144 Fed. 765, 771-775; *Wheeler v. Abilene Nat. Bank Bldg. Co.*, 159 Fed. 391, 393, 395, 16 L. R. A. (N. S.) 892, 14 Ann. Cas. 917; *Gamble v. Queens C. W. Co.*, 123 N. Y. 91, 99, 25 N. E. 201, 9 L. R. A. 527; *Heffern Co-op. Consol. Gold Min. & Mill. Co. v. Gauthier*, 22 Ariz. 67, 193 Pac. 1021; note 16 L. R. A. (N. S.) 898; *Fletcher Cyclopedia Corporations*, vol. 6, § 3973, 4035; 14 C. J., p. 870; § 1330.

¹⁴³ *Klein v. Independent Brewing Ass'n*, 231 Ill. 594, 83 N. E. 434; *Hodgman v. Atlantic Refining Co.*, 300 Fed. 590, rev'd 13 Fed. (2d) 781.

so that a wanton and fraudulent destruction of the rights of the minority may be restrained.¹⁴⁴

IV. BY-LAWS.

§ 178. In general.—A corporation has the power, implied when not conferred in express terms, to make such by-laws as may be reasonably necessary or proper, for the purpose of prescribing rules for its government, and regulating the conduct and defining the duties of its members, and to alter, amend, or repeal the same; but the power is subject to the following limitations:

- (1) By-laws must be reasonable, and not contrary to law.
- (2) They must not be inconsistent with the charter, enabling act, or articles of association.
- (3) They must not deprive a member of his vested rights, or impair the obligations of his contract of membership.
- (4) The power must be exercised by the authority and in the mode prescribed by the charter of the corporation or the general law.

Corporations are generally given the power to make by-laws for their government by express charter or statutory provision, but an express grant of such power is not necessary. The power is always implied, subject to the qualification that the by-laws must be reasonable, and not inconsistent with the charter of the corporation, nor contrary to the law, nor such as to impair or take away vested contract rights of stockholders or members, or of third persons.¹⁴⁵ Subject to the qualification above stated, a corporation may make by-laws fixing the time and place of holding corporate meetings, the mode of calling and conducting the same, and the manner of voting;¹⁴⁶ prescribing the qualifications of directors and other officers, the mode of electing or appointing them, providing for their

¹⁴⁴ In a note in 2 Minnesota Law Rev. 526, 528, it is said: "The power of the minority to resist dissolution of a prosperous corporation under these statutes, because of the motive of the majority is not clear on the authorities. On the one side is *Windmuller v. Standard Distilling & Distributing Co.*, 114 Fed. 491. The recent case of *In re Paine* [200 Mich. 58, 166 N. W. 1036] goes to the other extreme. The court held that dissolution would not be allowed

where the sole immediate purpose was to get rid of the minority as stockholders." See *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N. Y. 185, 123 N. E. 148.

¹⁴⁵ *Sutton's Hospital Case*, 10 Coke 30; *Matthews v. Associated Press of State of New York*, 136 N. Y. 333, 32 N. E. 981, 32 Am. St. Rep. 741.

¹⁴⁶ *Commonwealth v. Detwiller*, 131 Pa. St. 614, 18 Atl. 990, 992, 7 L. R. A. 357, 360.

removal, and defining their powers and duties;¹⁴⁷ and regulating, subject to qualifications elsewhere shown, the mode of transferring stock.¹⁴⁸

§ 179. Limitations upon the power to make by-laws.

The power of a corporation to make by-laws is not unlimited, but is subject to certain well-settled limitations.

By-laws must not be unreasonable or illegal.—In the first place, they must be reasonable and consistent with the law of the land. A by-law is void if it is unreasonable, or if it is in contravention of any statute, or of any settled principle of the common law, or if it is contrary to public policy.¹⁴⁹ Where the charter of a corporation vests the power to manage its affairs in a board of directors, it is not within the power of the corporation, by a by-law or otherwise, to vest the management in an executive committee.¹⁵⁰

It has been held that a majority of stockholders have no right under the form of a by-law to impose restrictions upon the minority in the free transfer of their stock, which are not specially authorized by statute or charter,¹⁵¹ such as a limitation upon the stockholder's right to transfer his stock without first offering it to the corporation. But the weight of authority seems to uphold the

¹⁴⁷ *Cross v. West Virginia Cent. & P. Ry. Co.*, 37 W. Va. 342, 16 S. E. 587, 18 L. R. A. 582; *In re A. A. Griffing Iron Co.*, 63 N. J. Law 168, 41 Atl. 931; s. c., 63 N. J. Law 357, 46 Atl. 1097; *Burden v. Burden*, 8 N. Y. App. Div. 160, 40 N. Y. Supp. 499, aff'd 159 N. Y. 287, 54 N. E. 17; *Savings Bank of Hannibal v. Hunt*, 72 Mo. 597, 37 Am. Rep. 449.

¹⁴⁸ *Ante*, §§ 146, 147. See *Ireland v. Globe Milling & Reduction Co.*, 19 R. I. 180, 32 Atl. 921, 29 L. R. A. 429, 61 Am. St. Rep. 756 (limitation on right to transfer without first offering stock to corporation); s. c., 21 R. I. 9, 41 Atl. 258, 79 Am. St. Rep. 769 ("A majority have no right under the form of a by-law, to impose restrictions upon a minority in the free transfer of their stock, which are not specially authorized by statute or charter, or which are not reasonably necessary to the business of the corporation.") But see *contra*, *Baumohl v. Goldstein*, 95 N. J. Eq. 597, note, 29 Yale Law Journal 352.

¹⁴⁹ *Powers v. Marine Engineers'*

Beneficial Ass'n No. 35, 52 Cal. App. 551, 199 Pac. 353; *Spayd v. Ringing Rock Lodge No. 665*, *Brotherhood of Railroad Trainmen of Pottstown*, 270 Pa. 67, 113 Atl. 70, 14 A. L. R. 1443.

¹⁵⁰ *Tempel v. Dodge*, 89 Tex. 69, 32 S. W. 514, 33 S. W. 222. See *ante*, § 101.

¹⁵¹ *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90; *Farmers' & Merchants' Bank of Lineville v. Wasson*, 48 Iowa 336, 30 Am. Rep. 398; *In re Klaus*, 67 Wis. 401, 29 N. W. 582; *Victor G. Bloede Co. v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L. R. A. 107, 57 Am. St. Rep. 373; *Brinkerhoff-Farris Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447, 24 S. W. 129; *Ireland v. Globe Milling Co.*, 21 R. I. 9, 41 Atl. 258, 79 Am. St. Rep. 769; *People's Home Sav. Bank v. Sadler*, 1 Cal. App. 189, 81 Pac. 1029; *Bloede Co. v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L. R. A. 107, 57 Am. St. Rep. 373. But see *Cowles v. Cowles Realty Co.*, 201 N. Y. App. Div. 460, 194 N. Y. Supp. 546.

validity of such restrictions as reasonable.¹⁵² A corporation cannot provide by a by-law for the sale or forfeiture of shares for nonpayment of assessments;¹⁵³ or impose or increase the liability of stockholders for corporate debts;¹⁵⁴ or confer upon stockholders the right to return their shares to the corporation at a fixed value, or limit their liability to creditors as fixed by law.¹⁵⁵

By-laws must be consistent with charter.—By-laws, to be valid, must not only be reasonable, and not in violation of the laws of the state, but they must also be consistent with the charter or articles of association of the corporation. If a by-law is inconsistent with any provision of the charter, enabling act, or articles of association of the corporation, or if it is in excess of the general powers conferred upon the corporation, it is void.¹⁵⁶ Thus, a national bank, since it is expressly prohibited from making loans on the security of shares of its own stock, cannot make a by-law reserving a lien on its shares for debts due from its stockholders.¹⁵⁷ A corporation cannot make a by-law vesting the management of its business in an executive committee, when the charter or enabling act vests the management in a board of directors.¹⁵⁸

Since a corporation has such powers only as are conferred upon it by its charter, and its powers cannot be added to by the consent of the shareholders, no power that is not given to a corporation by its charter can be conferred by a by-law.¹⁵⁹ Nor, on the other hand, can a by-law detract from the powers of a corporation. A

¹⁵² *Baumohl v. Goldstein*, 95 N. J. Eq. 597, 124 Atl. 118; *Wright v. Iredell Tel. Co.*, 182 N. C. 303, 108 S. E. 744; *Hassel v. Pohle*, 214 N. Y. App. Div. 654, 212 N. Y. Supp. 561; 29 *Yale Law Journal* 352; ante, §§ 146, 147.

¹⁵³ *In re Long Island R. Co.*, 19 Wend. (N. Y.) 37, 32 Am. Dec. 429.

¹⁵⁴ *Mitcham v. Citizens' Bank of Bullochville*, 34 Ga. App. 707, 131 S. E. 181 (a mere by-law attempting to impose individual liability on all members of a corporation held invalid, where neither statute or charter so provide); *Roush v. Longdale Independent Tel. Co.*, 78 W. Va. 136, 88 S. E. 623.

¹⁵⁵ *Verconture v. Golden State Land Co.*, 116 Cal. 410, 48 Pac. 375; *Wells v. Black*, 117 Cal. 157, 48 Pac. 1090, 37 L. R. A. 619, 59 Am. St. Rep. 162.

¹⁵⁶ *People's Home Sav. Bank v.*

Superior Court of City and County of San Francisco, 104 Cal. 649, 43 Am. St. Rep. 147; *Tempel v. Dodge*, 89 Tex. 69, 32 S. W. 514, 33 S. W. 222.

¹⁵⁷ *First Nat. Bank of South Bend v. Lanier*, 11 Wall. (U. S.) 369, 20 L. Ed. 172; *Conklin v. Second Nat. Bank of Oswego*, 45 N. Y. 655; *Feckheimer v. National Exch. Bank of Norfolk*, 79 Va. 80.

¹⁵⁸ *Tempel v. Dodge*, 89 Tex. 69, 32 S. W. 514, 33 S. W. 222. See ante, § 101.

¹⁵⁹ *State v. Utter*, 34 N. J. Law 489; *Brewster v. Hartley*, 37 Cal. 15, 99 Am. Dec. 237; *Traders' & Mechanics' Ins. Co. v. Brown*, 142 Mass. 403, 8 N. E. 134; *Steiner v. Steiner Land & Lumber Co.*, 120 Ala. 128, 26 So. 494. See *In re Corporation of Yaddo*, 216 N. Y. App. Div. 1, 214 N. Y. Supp. 523.

by-law prohibiting acts which are within the powers conferred, expressly or impliedly, by its charter, affects the authority of its officers, but does not render such acts *ultra vires*.¹⁶⁰

By-laws cannot impair vested contract rights of members or stockholders.—Although one of the offices of a by-law is to regulate the conduct and define the duties of the members of the corporation to the corporation and between themselves, the power to make by-laws gives a corporation no authority to make a by-law which impairs the obligation of contracts between it and its members or stockholders, or deprives them of vested rights thereunder, whether the contract be the contract of membership, or any other contract. Nor can the corporation deprive a member or stockholder of vested rights under a contract with a third person. Any by-law which has this effect, and which is not expressly authorized, is void as against a stockholder or member who does not consent.¹⁶¹ This principle applies where a corporation makes a by-law authorizing the issue of preferred stock, when it is not expressly authorized to issue preferred stock, and a holder of common stock objects.¹⁶² It also applies where a by-law is adopted without legislative authority, and without a stockholder's consent, imposing a liability upon stockholders to which they are not subject under their contract of membership, either to the corporation or to its creditors.¹⁶³ And it applies where a by-law impairs a stockholder's right to vote at corporate meetings.¹⁶⁴

§ 180. Adoption of by-laws.

The charter of a corporation or the general law may expressly vest the power to make by-laws in the board of directors, and in

¹⁶⁰ Kelly v. Mobile Building & Loan Ass'n, 64 Ala. 501. And see First Nat. Bank of Washington v. Eureka Lumber Co., 123 N. C. 24, 31 S. E. 348.

¹⁶¹ Kent v. Quicksilver Min. Co., 78 N. Y. 159; Bergman v. St. Paul Mut. Building Ass'n, 29 Minn. 275, 13 N. W. 120; Duluth Club v. MacDonald, 74 Minn. 254, 76 N. W. 1128, 73 Am. St. Rep. 344; Ireland v. Globe Milling Co., 21 R. I. 9, 41 Atl. 258, 79 Am. St. Rep. 769; People's Home Sav. Bank v. Superior Court of City and County of San Francisco, 104 Cal. 649, 38 Pac. 452, 29 L. R. A. 844, 43 Am. St. Rep. 147; Northport

Wesleyan Grove Camp-Meeting Ass'n v. Perkins, 93 Me. 235, 44 Atl. 893, 48 L. R. A. 272, 74 Am. St. Rep. 342.

¹⁶² Kent v. Quicksilver Min. Co., 78 N. Y. 159.

¹⁶³ Duluth Club v. MacDonald, 74 Minn. 254, 76 N. W. 1128, 73 Am. St. Rep. 344; Flint v. Pierce, 99 Mass. 68, 96 Am. Dec. 691; Reid v. Eaton-ton Mfg. Co., 40 Ga. 98, 2 Am. Rep. 563.

¹⁶⁴ People's Home Sav. Bank v. Superior Court of City and County of San Francisco, 104 Cal. 649, 38 Pac. 452, 29 L. R. A. 844, 43 Am. St. Rep. 147. See ante, § 170 et seq.

such a case it not only may, but must, be exercised by them, and not by the stockholders or members.¹⁶⁵ Unless the power is thus vested in the board of directors, it is vested in the stockholders or members, and cannot be exercised by the directors except under authority from them.¹⁶⁶ But the power may be delegated by the stockholders or members to the directors.¹⁶⁷ By-laws, to be valid, whether made by the stockholders or directors, must be adopted at a meeting called and conducted in accordance with the law and with the charter of the corporation.¹⁶⁸

§ 181. Alteration, repeal, and waiver of by-laws.

Unless prevented by charter or statutory provisions, and subject to the qualification that vested rights cannot be taken away or impaired, a corporation has the power, at any time, to alter, amend, or repeal by-laws adopted by it.¹⁶⁹ Indeed, a corporation cannot bind itself, by a provision in its by-laws or otherwise, not to alter or repeal the same.¹⁷⁰ As in the case of a statute, a by-law is impliedly repealed, *pro tanto* at least, by a subsequent by-law or resolution which is inconsistent with it.¹⁷¹ And a by-law may be modified or repealed by usage, and without any formal action.¹⁷² A corporation, however, cannot alter or repeal by-laws so as to affect the rights of members or stockholders, or of third

¹⁶⁵ *People v. Sterling Burial Case Mfg. Co.*, 82 Ill. 457; *Cahill v. Kalamazoo Mut. Ins. Co.*, 2 Doug. (Mich.) 124, 43 Am. Dec. 457; *Heintzelman v. Druids' Relief Ass'n*, 38 Minn. 138, 36 N. W. 100.

In such a case, however, a by-law adopted at a meeting called as a stockholders' meeting is valid if the stockholders and directors are the same persons, and all are present and participate. *People v. Sterling Burial Case Co.*, 82 Ill. 457. See also, *State ex rel. Daubenspeck v. Day*, 189 Ind. 243, 123 N. E. 402.

¹⁶⁶ *Morton Gravel Road Co. v. Wyson*, 51 Ind. 4; *North Milwaukee Town Site Co. No. 2 v. Bishop*, 103 Wis. 492, 79 N. W. 785, 45 L. R. A. 174; *Brinkerhoff-Farris Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447, 24 S. W. 129; *In re A. A. Griffing Iron Co.*, 63 N. J. Law 168, 41 Atl. 931; s. c., 63 N. J. Law 357, 46 Atl. 1097.

¹⁶⁷ *Rex v. Spencer*, 3 Burrows 1827.

See *Evans v. Southern Tier Masonic Relief Ass'n*, 76 N. Y. App. Div. 151, 78 N. Y. Supp. 611.

¹⁶⁸ *Mutual Fire Ins. Co. v. Farquhar*, 86 Md. 668, 39 Atl. 527.

¹⁶⁹ *Rex v. Ashwell*, 12 East 22; *Royal Bank of India's Case*, 4 Ch. App. 252; *Smith v. Nelson*, 18 Vt. 511; *Supreme Lodge, Knights of Pythias v. Knight*, 117 Ind. 489, 20 N. E. 479, 3 L. R. A. 409; *Crittenden v. Southern Home Building & Loan Ass'n*, 111 Ga. 266, 36 S. E. 643.

¹⁷⁰ *Malleson v. National Insurance & Guarantee Corp.*, 70 Law T. (N. S.) 157; *Smith v. Nelson*, 18 Vt. 511.

¹⁷¹ *Royal Bank of India's Case*, 4 Ch. App. 252.

¹⁷² *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 38 Am. Rep. 330; *Henry v. Jackson*, 37 Vt. 431; *Huxtable v. Berg*, 98 Wash. 616, 168 Pac. 187. But see *Powers v. Marine Engineers' Beneficial Ass'n No. 35*, 52 Cal. App. 551, 199 Pac. 353.

persons, which have become vested under contracts entered into in reliance on the by-laws.¹⁷³

As a corporation may alter or repeal by-laws at pleasure, subject to the limitations above stated, so, also, it may waive them, and it may do so either expressly or impliedly. If it acts or contracts in disregard of a by-law with the consent or acquiescence of the stockholders or members, there is a waiver of the by-law, at least *pro hac vice*, whether it is afterwards sought to set up the by-laws as against strangers or as against stockholders.¹⁷⁴

§ 182. Effect of by-laws upon stockholders or members.

If a by-law is such as the corporation has the power to make, it is binding upon all the stockholders or members, whether they consent to it or not; and it can make no difference whether they have actual notice of it or not, for they are chargeable with notice.¹⁷⁵ An invalid by-law may be binding as a contract. But a stockholder or member is not bound by a by-law to which he does not consent, either expressly or impliedly, if it impairs his rights under his contract of membership, although it may be one which might be adopted by unanimous consent of the stockholders or members.¹⁷⁶ If a person becomes a stockholder or member of a corporation after the adoption of a by-law which is not illegal, he impliedly consents to it, and it enters into his contract with the corporation. He cannot object to it on the ground that it impairs his rights as a stockholder or member, whether he knew of it or not, for he is chargeable with notice of it.¹⁷⁷

¹⁷³ Kent v. Quick, 117 Min. Co., 78 N. Y. 159; Wist v. Grand Lodge, A. O. U. W., 22 Ore. 271, 29 Pac. 610, 29 Am. St. Rep. 603; Loewenthal v. Rubber Reclaiming Co., 52 N. J. Eq. 440, 23 Atl. 454; Supreme Lodge, Knights of Pythias v. Knight, 117 Ind. 489, 20 N. E. 479, 3 L. R. A. 409; Becker v. Berlin Beneficial Soc., 144 Pa. St. 232, 22 Atl. 699, 27 Am. St. Rep. 624.

¹⁷⁴ Clark v. New England Mut. Fire Ins. Co., 6 Cush. (Mass.) 342, 53 Am. Dec. 44; Susquehanna Mut. Fire Ins. Co. v. Elkins, 124 Pa. St. 484, 17 Atl. 24, 10 Am. St. Rep. 608; Currier v. Continental Life Ins. Co., 53 N. H. 538.

¹⁷⁵ McFadden v. Board of Sup'rs Los Angeles Co., 74 Cal. 571, 16 Pac. 397; Weatherly v. Medical & Surgi-

cal Society of Montgomery Co., 76 Ala. 567; Haden v. Farmers' & Mechanics' Fire Ass'n, 80 Va. 683. See Mutual Life Ins. Co. v. McSherry, 68 Md. 41, 11 Atl. 577. Compare, however, McKenney v. Diamond State Loan Ass'n, 6 Houst. (Del.) 557. See also, State ex rel. Webber v. Shaw, 103 Ohio St. 660, 134 N. E. 643.

¹⁷⁶ A by-law is, in one aspect, a contract between the corporation and its members. People's Home Sav. Bank v. Sadler, 1 Cal. App. 189, 81 Pac. 1029; Costello v. Portsmouth Brewing Co., 69 N. H. 405, 43 Atl. 640; State ex rel. Webber v. Shaw, 103 Ohio St. 660, 134 N. E. 643.

¹⁷⁷ Matthews v. Associated Press of State of New York, 136 N. Y. 333, 32 N. E. 981, 32 Am. St. Rep. 741.

A stockholder in a corporation is not chargeable with notice of the resolutions or by-laws adopted by its directors or the other stockholders, in so far as his dealings with it otherwise than as a stockholder are concerned, but is in the same position as any stranger dealing with it. Thus, a stockholder of a telegraph company, dealing with it as a customer in sending messages, is not chargeable with constructive notice of resolutions or by-laws regulating the mode in which its business must be conducted with its customers, and his rights as a customer are not affected thereby unless actual notice is brought home to him.¹⁷⁸

§ 183. Effect of by-laws with respect to third persons.

Persons dealing with a corporation or with stockholders therein are chargeable with notice of, and are bound by, any by-laws which are in express terms authorized by the charter of the corporation.¹⁷⁹ And they are bound by by-laws of which they have actual notice.¹⁸⁰ But they are not chargeable with notice of by-laws not expressly authorized, and are not bound thereby unless they have actual notice of them.¹⁸¹ This is true, for example, of by-laws imposing limitations upon the apparent powers of particular officers of a corporation with respect to the making of contracts, the issue of certificates of stock, transfers of stock, etc.,¹⁸² by-laws not expressly authorized, reserving a lien on shares

¹⁷⁸ *Pearsall v. Western U. Tel. Co.*, 124 N. Y. 256, 26 N. E. 534, 21 Am. St. Rep. 662.

¹⁷⁹ *Brent v. Bank of Washington*, 10 Pet. (U. S.) 596, 9 L. Ed. 547; *Haden v. Farmers' & Mechanics' Fire Ass'n*, 80 Va. 683; *Bloomington v. Cushman*, 134 Minn. 445, 159 N. W. 1078.

¹⁸⁰ *Phillips v. Interstate Land Co.*, 174 N. C. 542, 94 S. E. 12; *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 355; *Hale v. Mechanics' Mut. Fire Ins. Co.*, 6 Gray (Mass.) 169, 66 Am. Dec. 410 (where a by-law of mutual insurance printed on a policy was held binding on the insured); *Fletcher, Corporations*, sec. 502, p. 1926.

¹⁸¹ *Newton v. Johnston Organ & Piano Mfg. Co.*, 180 Cal. 185, 180 Pac. 7; *Uline Loan Co. v. Standard Oil Co.*, 45 S. D. 81, 185 N. W. 1012, 27 A. L. R. 585; *Smith v. Smith*, 62 Ill. 493; *Johnston v. Milwaukee & W. Inv. Co.*, 46 Neb. 480,

64 N. W. 1100; *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187; *Tome v. Parkersburg Branch R. Co.*, 39 Md. 36, 17 Am. Rep. 540; *Worcester v. Essex Merrimac Bridge Corp.*, 7 Gray (Mass.) 457; *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 38 Am. Rep. 330; *Pearsall v. Western U. Tel. Co.*, 124 N. Y. 256, 26 N. E. 534, 21 Am. St. Rep. 662; *Barnes v. Black Diamond Coal Co.*, 101 Tenn. 354, 47 S. W. 498; *Walker v. Wilmington, C. & A. R. Co.*, 26 S. C. 80, 1 S. E. 366. Compare, however, *Commonwealth v. Vandergrift*, 232 Pa. 53, 81 Atl. 153, 36 L. R. A. (N. S.) 45, Ann. Cas. 1912 C 1267; 36 Yale Law Journal 326.

¹⁸² *Tome v. Parkersburg Branch R. Co.*, 39 Md. 36, 17 Am. Rep. 540; *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 355; *Kelly v. Mobile Building & Loan Ass'n*, 64 Ala. 501; *Havana Cent. R. Co. v. Central Trust Co. of New York*, 204

of stock for debts from the stockholders, etc.¹⁸³ As a rule, by-laws merely regulating the management of a corporation and the duties of its officers, etc., are not intended to and do not affect the rights of third persons dealing with the corporation.¹⁸⁴

If a person contracts with a corporation with reference to a by-law, as, for example, a by-law by which the stockholders or members bind themselves individually for all debts that may be contracted by the corporation, the by-law becomes a part of his contract, and he may enforce the same; but it is otherwise if he does not contract with reference to or on the faith of the by-law.¹⁸⁵

Fed. 546, L. R. A. 1915 B 715; *Hartford v. Massachusetts Bowling Alleys*, 229 Mass. 30, 118 N. E. 188. Compare, *Lutz v. Webster*, 249 Pa. 226, 94 Atl. 834. See *Fletcher, Corporations*, secs. 502, 1931, 1963.

¹⁸³ *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 38 Am. Rep. 330; *Driscoll v. West, Bradley & Cary Mfg. Co.*, 59 N. Y. 96; *Des Moines Nat. Bank v. Warren County Bank*, 97

Iowa 204, 66 N. W. 154; *Anglo-Californian Bank v. Grangers' Bank*, 63 Cal. 359; *Bronson Elec. Co. v. Rheubottom*, 122 Mich. 608, 81 N. W. 563.

¹⁸⁴ *Smith v. Smith*, 62 Ill. 493; *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187.

¹⁸⁵ *Flint v. Pierce*, 99 Mass. 68, 96 Am. Dec. 691.

CHAPTER XVI.

STOCKHOLDERS' SUITS.

§ 184. **In general.**—A stockholder or member of a corporation has the same right as a stranger to sue the corporation or its officers or agents to enforce his individual rights, or obtain redress for individual injuries.

A stockholder, however, cannot maintain an action at law against the corporation, or its officers or agents, or third persons, to enforce a right belonging to the corporation, or to redress an injury to the corporation, but the action must be brought by the corporation.

As a general rule, the same is true of suits in equity to enforce rights belonging to the corporation, or to enjoin or redress injuries to the corporation. A stockholder may sue in equity, however, to compel the corporation to assert its rights, or prevent fraud on the minority, if he cannot obtain relief through the corporation. He may sue in equity on behalf of himself and the other stockholders who may come in:

- (1) When there is some action or threatened action of the board of directors or trustees which is beyond the powers conferred upon the corporation by its charter.
- (2) Or where the corporation is violating its obligation to the stockholders to assert its rights of action or defenses against officers or third parties.
- (3) But before the stockholder can maintain a suit in his own name, where the right of action is in the corporation, he must show to the satisfaction of the court that he has exhausted all the practicable means within his reach to obtain relief or redress within the corporation itself. He must have made an earnest effort to induce remedial action on the part of the board of directors or trustees, and, according to some decisions, to obtain action by the stockholders as a body, if the transaction complained of admits of ratification, or they have control over the directors, or he must show that the circumstances were such that such an effort would have been useless.

- (4) A stockholder cannot sue where the act complained of, or the refusal of the directors to sue, is properly within their discretionary powers, or, generally, the discretionary powers of a majority of the stockholders.
- (5) A stockholder cannot sue in such cases where he or his assignor has been guilty of laches, or is estopped by participation, consent, or acquiescence.

§ 185. Individual and corporate rights of action.

A stockholder may sue the corporation to recover a dividend after it has been declared, for he then has a right to the money in his individual capacity. A stockholder or member of a corporation may also proceed against a corporation, or its officers in a proper case, by an action at law for damages, or by a suit in equity, or by *mandamus*, according to the circumstances, where he is wrongfully refused a certificate of stock; where he is wrongfully denied the rights of membership; where his shares are wrongfully forfeited or sold for nonpayment of assessments; where the corporation or its officers wrongfully refuse to recognize a valid transfer of stock; where they recognize an unauthorized or forged transfer and issue a certificate, thereby depriving him of his stock; where they wrongfully refuse to allow him to inspect the books and papers of the corporation, or to vote at corporate meetings; where he was induced to purchase his stock by fraud for which the corporation or its officers are responsible; where there is a fraudulent and unequal disposition of unissued stock in violation of his right to a proportionate share; or where he is wrongfully denied the right to subscribe for or purchase a proportionate share of increased stock; and in many other cases.¹

It has been held that a fraudulent increase of stock made and issued to others for the express purpose and with the clear result of depriving plaintiffs of their relative position as stockholders worked an injury to their rights individually as between them and the corporation, although the same acts might be made the basis of an action by or in behalf of the corporation to remedy the injury inflicted upon it and through it upon all of the stock-

¹ *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 78 N. E. 1090, 12 L. E. A. (N. S.) 969, 9 Ann. Cas. 738; *Travis v. Knox Terpezone Co.*, 215 N. Y. 259, 109 N. E. 250, L. R. A. 1916 A 542, Ann. Cas. 1917 A 387; *Waters v. Waters & Co.*, 201 N. Y.

184, 94 N. E. 602. See 2 *Pomeroy*, Eq. Jur., sec. 1091; 2 *Machen*, Corporations, sec. 1152. As to individual, direct right of action to enjoin threatened *ultra vires* acts, see post, § 188.

holders in common.² Taft, J., says in *Ritchie v. McMullen*,³: "A stockholder, merely as such, cannot have an action in his own behalf against one who has injured the corporation, however much the wrongful acts have depreciated the value of his shares. But we are of opinion that this principle has no application where the wrongful acts are not only wrongs against the corporation, but are also violations by the wrongdoer of a duty arising from contract or otherwise, and owing directly by him to the stockholders."

In a Minnesota case⁴ a stockholder requested the managing officers of a corporation to bring suit to cancel stock issued in pursuance of an alleged fraudulent contract. This they refused to do though admitting that the contract was fraudulent. It was contended that the bringing of such an action was a matter within the discretion of the board of directors, in the absence of fraud, and that application should have been made to the stockholders. It was held that neither of these objections was well taken. It was the plain duty of the officers to protect the stockholders and the corporation from the fraud of others, and refusal to do so was not within their discretion. The court said: "There is respectable authority for the proposition that where stock of a corporation has been fraudulently issued by its officers, the stockholders may sue for its cancellation without requesting that the action be brought by the corporation. The action is in such case not in interests of the corporation, but in the interests and for the protection of the individual rights of stockholders. . . . Here the injury complained of, and consequently the right of action, accrued to the stockholders and not to the corporation as such."

As a general rule, however, a stockholder cannot sue to enforce rights which belong to the stockholders collectively,—that

² *Witherbee v. Bowles*, 201 N. Y. 427, 95 N. E. 27. That a representative suit will lie to cancel stock issued fraudulently in exchange for worthless land, see *James v. P. V. Steifer Min. Co.*, 35 Cal. App. 778, 171 Pac. 117. The stockholder cannot join an individual cause of action with one asserted on behalf of the corporation. *Brock v. Poor*, 216 N. Y. 387, 111 N. E. 229; *Ringler v. Jetter*, 206 N. Y. App. Div. 478, 201 N. Y. Supp. 523.

³ 79 Fed. 522, 533, 534, modifying 64 Fed. 253. A stockholder pledged his stock as collateral with directors of a corporation. They conspired to bring about a depreciation of the

stock so that they could buy it in cheaply. It was held that the pledgor had a personal or direct right of action against the directors. See *General Rubber Co. v. Benedict*, 215 N. Y. 18, 109 N. E. 96, L. R. A. 1915 F 617; *Krohn v. Williamson*, 62 Fed. 869; 23 Columbia Law Rev. 498.

⁴ *Shaw v. Staight*, 107 Minn. 152, 119 N. W. 951, 20 L. R. A. (N. S.) 1077; 9 Columbia Law Rev. 445. See *Stebbins v. Perry County*, 167 Ill. 567, 47 N. E. 1048; *Witherbee v. Bowles*, 201 N. Y. 427, 95 N. E. 27; 1 Fletcher, Corporations, secs. 142, 4062.

is, to the corporation,—or to redress or prevent injuries to the corporation. This distinction between the individual and the collective rights of stockholders is of the greatest importance. Even when all the stock of a corporation is owned by one person, the rights under a contract by the corporation are its rights, and not the rights of the individual. Except as hereafter explained, such rights, therefore, must be enforced, not by the stockholders individually, but by the corporation. In like manner, if the property of a corporation is converted by a stranger, or if a trespass is committed thereon, or if an injury to its property is caused by the negligence of another, or if an injury is threatened, the injury is to the corporation, not to the stockholders individually, and it is for the corporation, and not for the stockholders as individuals, to take proper steps, by action or otherwise, to prevent or redress the injury. This is true when a corporation is injured by the fraud, excess of authority, or negligence of its own officers or agents. The injury is primarily to the corporation, and not to the individual stockholders, and it is for the corporation to seek redress.⁵

Neither a single stockholder nor all the stockholders, as individuals, can maintain an action at law in their own names upon a contract made by the corporation, or for injuries committed against the property of the corporation. All such actions must be brought in the corporate name, and cannot be maintained by stockholders in their own names. This principle applies, whether the wrongs complained of are the acts or negligence of strangers, or the fraudulent or wrongful acts or negligence of the directors or managing officers of the corporation.⁶ The fact that one person owns all the

⁵ *Converse v. United Shoe Mach. Co.*, 209 Mass. 539, 95 N. E. 929 (bill in equity cannot be maintained for injury to stockholder's individual interests by wrongdoing of defendants as stockholders and officers in conduct of business of the company or to enable stockholders to recover individually for damages suffered by them); *Smith v. Hurd*, 12 Metc. (Mass.) 371; *Pratt v. Bacon*, 10 Pick. (Mass.) 123; *Seitz v. Michel*, 148 Minn. 80, 181 N. W. 102, 12 A. L. R. 1060. See Glenn, 33 Yale Law Journal 580; 22 Harvard Law Rev. 594; 28 Harvard Law Rev. 409.

One stockholder is not entitled to an injunction against other stock-

holders against taking possession of books and property of the corporation and manipulating it so as to exclude plaintiff from the profits, on the ground that it is a partnership under corporate form. The only remedy of the stockholders is in an action by the corporation or in a representative suit. *Boag v. Thompson*, 208 N. Y. App. Div. 132, 203 N. Y. Supp. 395.

⁶ *United Copper Securities Co. v. Amalgamated Copper Co.*, 244 U. S. 261, 61 L. Ed. 1119, 37 Sup. Ct. 509; *Button v. Hoffman*, 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131; *Smith v. Hurd*, 12 Metc. (Mass.) 371, 46 Am. Dec. 690; *Converse v. United Shoe Machinery Co.*, 185 Mass. 422,

stock of a corporation does not enable him to sue in his own name for an injury to the corporation, for the corporation is none the less a separate and distinct person in the law.⁷

It makes no difference in the application of this rule that the injury is caused by the officers of the corporation in their management of its affairs. Misfeasance or negligence on the part of the managing officers of a corporation, resulting in loss of its assets, is an injury to the corporation, for which it must sue. A stockholder cannot sue for damages because his stock is rendered worthless.⁸ The officers owe no duty to the stockholders individually. The injury done to the capital and assets of the corporation by their negligence or malfeasance is an injury to the whole body of stockholders in common. The creditors also may be interested in the proceeds of the claim, and the interest of the stockholders is subordinate to theirs. A stockholder has no right of action against the corporation because of a depreciation in the value of his stock in common with the rest of the stock, but must show some injury and damage peculiar to himself.⁹ To permit stockholders to sue separately because the value of their stock is impaired by a wrong done to the corporate rights or property would result in a multiplicity of actions. A single action by the corporation will obtain redress for the wrong done to the common property in favor of all the stockholders and also of creditors who may be interested in the assets.

§ 186. Basis of the right of stockholders to bring a representative suit in equity.

Various theories have been suggested to explain the ground upon which the stockholder is allowed to sue in equity to compel the assertion of a corporate right of action. One theory is that "the right of the stockholder to sue exists because of special injury to him for which he is otherwise without redress."¹⁰ The idea is

70 N. E. 444; *Tomlinson v. Bricklayers' Union* No. 1, 87 Ind. 308; *Talbot v. Scripps*, 31 Mich. 268; *Allen v. Curtis*, 26 Conn. 456; *McAfee v. Zettler*, 103 Ga. 579, 30 S. E. 268.

⁷ *Button v. Hoffman*, 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131. See *Oeland v. Woldenberg*, 185 Wis. 510, 210 N. W. 807.

⁸ *Smith v. Hurd*, 12 Metc. (Mass.) 371, 46 Am. Dec. 690; *Bartlett v.*

New York, N. H. & H. R. Co., 221 Mass. 530, 109 N. E. 452.

⁹ *Oliphant v. Woodburn Coal & Mining Co.*, 63 Iowa 332; *Niles v. New York Cent. & H. R. R. Co.*, 176 N. Y. 119, 68 N. E. 142.

¹⁰ *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N. W. 1024, 60 L. R. A. 927, 108 Am. St. Rep. 716. See 21 *Harvard Law Rev.* 202; *Morrill v. Little Falls Mfg. Co.*, 46 Minn. 260, 48 N. W. 1124. The true basis of the

that he sues because of the special indirect damage to himself as a stockholder by the wrong to the corporation. It is even argued that if one was not a stockholder at the time, he was not injured, and can take no advantage of a right of action in his vendor. This confuses a representative suit with a suit by a stockholder for an injury to himself.

It is commonly said that "the plaintiff does not sue in his own right, but in that of the corporation." Hence the terms "representative" or "derivative" suit. Is the plaintiff a representative of the corporation or of the other stockholders? It would seem of the corporation. It has been said that such a suit is in legal effect a suit by the corporation conducted by the stockholder as its voluntary representative.¹¹ In *Foss v. Harbottle*,¹² the vice chancellor speaks of the plaintiffs assuming to themselves the right and power to sue on behalf of and represent the corporation itself, although not in its name.

In *Whitten v. Dabney*,¹³ plaintiffs sued to redress wrong which the corporation itself had suffered. Henshaw, J., said that the plaintiffs occupied a fiduciary relation to the corporation. "Their position may not inaptly be compared to that of a *guardian ad litem*. . . . The stockholder does not bring such a suit because his rights have been directly violated, or because the cause of action is his, or he is entitled to relief." In its essence it is an action brought by the corporation itself to recover redress for some legal wrong to the corporation.

The theory may, however, be suggested that the true basis of the stockholder's suit is an obligation owed by the corporation to the

right of stockholders to sue is not because the wrongs to the corporation are in their essential character wrongs to the stockholders individually, as this case seems to suggest, but rather the duty which the corporation owes to each stockholder to assert and protect its rights, which may be specifically enforced for the benefit of the stockholders.

11 A representative suit is in legal effect a suit by the corporation conducted by the stockholder as its voluntary representative. He is without authority to bind the corporation either for costs or attorneys' fees. When successful the court may make the expense, including attorneys' fees, a charge against the corporation. *Er-*

iksson v. Boyum, 150 Minn. 192, 197, 184 N. W. 961; *Graham v. Dubuque Specialty Mach. Works*, 138 Iowa 456, 114 N. W. 619, 15 L. R. A. (N. S.) 729. See Glenn, 33 Yale Law Journal 590.

12 2 Hare 461.

13 171 Cal. 621, 154 Pac. 312. The court speaks of the corporation as being under disability while under the control of the recreant board of directors, and the stockholder goes into equity seeking redress precisely as a *guardian ad litem* goes into court to obtain redress for a minor or incompetent person. This is a novel view of the status of the stockholder suing in behalf of the corporation.

stockholders, like the obligation of a trustee to the beneficiary, which may be specifically enforced when the corporation is put in default in its duty to preserve the corporate property, and assert its rights and claims against wrongdoers.^{13a} Where an action is brought by a stockholder against the corporation and other defendants to set aside illegal transfers made by it, he must allege in his complaint in effect two causes of action: First, a good cause of action in favor of the company in which he is a stockholder; and second, facts which show a breach of duty by the corporation in failing to assert that cause of action and which make it necessary to sue the corporation to compel the performance of it.

Rights of shareholder.—The owner of shares is entitled to participate in the net profits earned equally with other stockholders of similar class, to enforce the use of the capital for the designated corporate purposes, to restrain abuses of corporate powers, and to receive his proportion of the property remaining after payment of debts upon dissolution. In most corporations he may also vote in the election of directors and in such direction of corporate affairs as may be vested in stockholders. He is also entitled to have the management of the corporation defend it against wrongdoers and bring suit when the occasion demands this for the protection of the interests of the stockholders.¹⁴ As is said by the Delaware court in *Harden v. Eastern States Public Service Co.*:¹⁵ "When those in control of the corporation and its assets misuse their power and wrongfully occasion loss and damage, the injury done thereby has been done to the owner of the property—the corporation. . . . It follows, therefore, that whatever cause of action may exist by reason of this breach of duty exists in favor of the cor-

^{13a} See *Beling v. American Tobacco Co.*, 72 N. J. Eq. 32, 65 Atl. 725: "The specific performance of a continuing contract in writing, consisting of a certificate of capital stock."

"It was the corporation's duty to bring the action, and the plaintiff's cause of action arose only when it refused or failed to bring it, and in such case it should be joined as a party defendant." *Security Trust Co. v. Pritchard*, 201 N. Y. App. Div. 142, 194 N. Y. Supp. 486, 491, citing *Kavanaugh v. Commonwealth Trust Co.*, 181 N. Y. 121, 73 N. E. 562.

¹⁴ It has been said that: "A corporation holds its property as the

trustee of its stockholders, and they have a right, like any other *cestui que* trust, to have the trust property judiciously and honestly managed and preserved from waste and misappropriation." Per *Van Fleet, V. C.*, in *Rabe v. Dunlap*, 51 N. J. Eq. 40, 25 Atl. 959.

¹⁵ 14 Del. Ch. 156, 122 Atl. 705. See *Myers v. Occidental Oil Corp.* (D. C.), 288 Fed. 997; *Smith v. Stone*, 21 Wyo. 62, 128 Pac. 612; *Continental Security Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112, Ann. Cas. 1914 A 777; 6 Fletcher's Cyc. Corp., par. 4061.

poration. The stockholders, however, who are to be regarded as the ultimate beneficial owners of the corporate assets, have an interest therein which equity in a proper case will protect. It is the duty of the corporation itself to proceed to redress the wrongs done to it and thus mediate to safeguard the interests of its stockholders. . . . Their right is strictly a derivative one, and the relief obtained belongs to the corporation and not to themselves."

The neglect or refusal of the corporation to act by its management is a breach of duty to the stockholders individually and a violation of their right to have the corporation defend itself against wrong and assert rights of action which it would be mismanagement to neglect.¹⁶ The board of directors is under duty to manage corporate affairs with due diligence for the benefit of all the stockholders. A violation by the directors of their duty to the corporation to bring suit in its behalf gives rise to a right of action for specific performance of the corporate duty to the stockholders. The stockholder in these cases in effect gets specific performance of the obligation of the corporation to enforce a corporate right because of the effect upon himself and other stockholders if the corporation fails to act. The procedure is to bring the suit against the corporation and also against the parties liable to the corporation. The suit cannot be maintained unless it is necessary because of the neglect and refusal of the corporation to act. The plaintiffs must therefore set forth two causes of action; first, a cause of action in favor of the corporation; second, the facts which entitle the plaintiffs to maintain the action for the corporation.¹⁷ The suit for specific performance of the corporation's duty to sue embraces also the bringing of the corporate suit in order that complete relief may be given in the same proceeding. It is possible in some cases that there might be a decree directing the corporation to sue at law, or, if it fails to do so, permitting the stockholder to sue in

¹⁶ *Wilson v. Brown*, 269 Pa. 225, 112 Atl. 1. Refusal of the corporate management to act must be shown to be a disregard of duty amounting to a breach of trust and not a mere error of judgment.

¹⁷ *Dickinson v. Consolidated Trust Co.*, 114 Fed. 232, 239. Because of failure of the corporation to seek a remedy for its wrongs by suit a stockholder may sue and fight the battle which the corporation ought to fight. Though the corporation is brought

into court as one of the defendants, its real status as to the other defendants is that of a plaintiff and the relief sought will enure to its benefit and through it to the stockholders.

A proper demand on the corporation to sue is an essential element of the cause of action and it must appear from the complaint that such a demand was made or that it is excused. *Flynn v. Brooklyn City R. Co.*, 158 N. Y. 493, 53 N. E. 520.

its name and on its behalf, as where a statute only authorizes an action at law for treble damages to be recovered through the verdict of a jury. There seem, however, no cases thus far where this has been allowed.¹⁸ It has been held that the stockholders of a holding company may maintain a representative action for the benefit and in behalf of the subsidiary company, the directors of both companies having refused, after due request, to institute an action in the name of either company.¹⁹ This may be explained as the specific enforcement of the duty of the holding company to compel the subsidiary to assert its rights, the duty being owed by the respective corporations to their stockholders.

§ 187. Suits to enjoin or set aside ultra vires transactions, and prevent diversion or misapplication of assets.

Each stockholder has contributed his share of the capital stock under a contract with the corporation, by which the corporation has agreed to hold and manage the same for the purpose of carrying out the enterprise and objects for which it was created, and for no other purpose, and every stockholder has a right to insist that this contract shall be complied with. In equity, therefore, an obligation is created by implication in favor of the stockholders, that the corporation will confine itself to the objects authorized, and that it will use and apply its assets for the purpose of carrying out those objects, and not divert them to other purposes.²⁰ The relation of the stockholder to the corporation is

¹⁸ *Fleitmann v. Welsbach Street Lighting Co. of America*, 240 U. S. 27, 60 L. Ed. 505, 36 Sup. Ct. 233. See *Busch v. Mary A. Riddle Co. of Delaware*, 283 Fed. 443: "Possibly a stockholder should, under certain restrictions, particularly in instances where the right to bring the suit in the name of a stockholder is worthless, be permitted to maintain such suits in the name of the corporation (whether that corporation be the one in which he is a stockholder or a subsidiary, mediate or immediate, thereof). But the law in this country does not now recognize such a procedure."

¹⁹ Stockholders of a holding company may maintain a representative action for the benefit and in the behalf of the subsidiary company, the directors of both companies having refused, after due request, to institute an action in the name of either

company. *Post*, note 45; *Holmes v. Camp*, 180 N. Y. App. Div. 409, 411, 167 N. Y. Supp. 840, 841; *European & N. A. Ry. v. Poor*, 59 Me. 277. The holding company owes a duty to use its control of the subsidiary to compel the subsidiary to sue to right wrongs to it, and the stockholder may in effect compel specific performance of these connected duties.

²⁰ "As the shareholders are in substance partners in a trading concern the management of which is committed to the body corporate, a trust is by implication created in favor of the shareholders that the corporation will manage the corporate affairs, and apply the corporate funds for the purpose of carrying out the original speculation." *Taylor v. Chichester & Midhurst Ry. Co.*, L. R. 2 Exch. 378. See also, *Russell v. Wakefield Water Works Co.*, L. R. 20 Eq. 474;

similar in many ways to that between a beneficiary and a trustee. The capital and business relations with the outside world are held by the corporation as a distinct legal person. The stockholders are the ultimate beneficiaries for whom the business is being conducted by their representative. They have the right to have the corporate property and affairs managed for their benefit in accordance with the charter. The trust purposes for which the capital is contributed are declared in the charter.²¹ Nothing, therefore, is now more surely settled in the law of corporations than the doctrine that any unauthorized act or contract by the directors or a majority of the stockholders of a corporation, which will destroy the existence of the corporation, or render it unable to perform its functions, or any misapplication or diversion of assets to purposes not authorized by its charter, even though all other stockholders may consent, is a breach of obligation towards a dissenting stockholder, against which he is entitled to relief in equity. Any stockholder, therefore, may maintain a bill in equity in his own name, if he is not estopped, to enjoin a threatened misapplication or diversion of its assets, or to enjoin or set aside *ultra vires* acts or contracts which will result in such a misapplication or diversion, or which may destroy the corporation, or render it unable to carry out its objects.²² No majority of stockholders, however large, may ratify or sanction the misapplication of the capital to purposes unauthorized by the charter.

A stockholder who has grounds to believe that his corporation is about to be launched on an illegal or *ultra vires* act may sue to restrain it therefrom, and need not necessarily invoke the aid of equity in a representative suit in behalf of all. Since the thing complained of is only threatened, his individual rights and interests are such that he may sue in his own behalf to obtain protection against the wrong about to be perpetrated against him by the

Peabody v. Flint, 6 Allen (Mass.) 52; Dodge v. Woolsey, 18 How. (U. S.) 331, 15 L. Ed. 401.

²¹ W. F. Boardman Co. v. Petch, 186 Cal. 476, 199 Pac. 1047, 1050. See also, Hobbs v. Tom Reed Gold Min. Co., 164 Cal. 497, 501, 129 Pac. 781, 43 L. R. A. (N. S.) 1112.

²² Tomkinson v. Southeastern Ry. Co., 35 Ch. Div. 675; Seaton v. Grant, 2 Ch. App. 459; Colman v. Eastern Counties Ry. Co., 10 Beav. 1; Hoole v. Great Western Ry. Co., 3 Ch. App.

262; Dodge v. Woolsey, 18 How. (U. S.) 331, 15 L. Ed. 401; Blair v. Telegram Newspaper Co., 172 Mass. 201, 51 N. E. 1080; Zabriskie v. Hackensack & N. Y. R. Co., 18 N. J. Eq. 178, 90 Am. Dec. 617; Kean v. Johnson, 9 N. J. Eq. 401; Abbot v. American Hard Rubber Co., 33 Barb. (N. Y.) 578; Leslie v. Lorillard, 110 N. Y. 519, 18 N. E. 363, 1 L. R. A. 456; Carter v. Producers' & Refiners' Oil Co., 164 Pa. 463, 30 Atl. 391.

corporation.²³ But when an *ultra vires* or illegal transaction is consummated and a wrong has been done to the corporation, then the stockholder's right to sue is derivative and not primary. If the corporation ought to bring suit against some third person and refuses to do so, the minority stockholder may compel the assertion of the right which the corporation fails to assert, after he has made *bona fide* efforts to induce it to act, by making the corporation a defendant, though its real status is that of plaintiff.²⁴

§ 188. Suits for redress or relief in case of fraud, excess of authority, or negligence of directors or other officers.

If the directors or other officers of a corporation exceed their authority, not under an honest mistake, or are guilty of fraud or negligence in the management of the affairs of the corporation, causing loss to the corporation, the corporation may sue them for redress. In such a case, the right to sue for redress is in the corporation, for the injury is to the stockholders collectively, and individually stockholders cannot maintain a suit for relief or redress, unless for some reason it cannot be obtained through the corporation. If for any reason, however, relief or redress cannot be obtained through the corporation, as where the guilty directors own a majority of the stock, or the majority of the stockholders approve of or acquiesce in the fraud or mismanagement, or will not sue or take other steps to prevent the same, or hold the directors liable, or where there is no time to obtain action by the stockholders, any stockholder may obtain appropriate relief for the benefit of the corporation by a suit in equity on behalf of himself and other stockholders. The suit may be maintained under such circumstances in any case in which it appears that the directors or other officers are exceeding their authority or have been fraudulently

²³ *Alexander v. Atlanta & W. P. R. Co.*, 113 Ga. 193, 203, 38 S. E. 772, 54 L. R. A. 305. Any single stockholder may file a bill to restrain the corporation from exceeding its powers. He is not compelled to ask the corporation to institute suit. He stands upon his contract which exists between the corporation and the stockholders in the articles of incorporation. See also, *Dickinson v. Consolidated Traction Co.*, 114 Fed. 232, 239; *American Ice & Industries Co. v. Crane*, 142 Ala. 620, 39 So. 233; *Hoole v. Great Western R. Co.*, L. R.

3 Ch. App. 262; *Bigelow v. Calumet & Hecla Min. Co.*, 155 Fed. 869; *General Inv. Co. v. Lake Shore & M. S. Ry. Co.*, 250 Fed. 160, 174. Stockholder may seek in his own direct right to enjoin corporation from doing an illegal or *ultra vires* act.

A representative suit also lies to prevent a threatened injury such as illegal payments. *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429, 553, 39 L. Ed. 759, 15 Sup. Ct. 673 (*Income Tax Law of 1894.*)

²⁴ *Morris v. Elyton Land Co.*, 125 Ala. 263, 28 So. 513, 516.

managing the affairs of the corporation in their own interest, or in the interest of any other person than the corporation and its stockholders, or that they have converted the assets of the corporation to their own use, or that they have neglected or are neglecting their duty, to the injury of the corporation. And the suit may be either to enjoin or remove them, or to compel them to account or make good the loss to the corporation, or both.²⁵

§ 189. Necessity for effort to obtain relief through the corporation or its officers.

The right of a stockholder to sue in equity to prevent or redress injuries to the corporation, depends upon a breach of obligation to assert its just rights by the corporation or its officers. The right to sue is primarily in the corporation; and in order that a stockholder may sue in its behalf, he must show in his bill or complaint that he has made every reasonable effort, in good faith, to obtain relief within and through the corporation by requesting the directors or other officers to sue or take other proper steps, and, on their refusal to do so, by applying to the stockholders; or else he must show that such a request and application would be useless because the directors and majority of the stockholders are themselves guilty of the wrongs complained of, or because the directors refuse to act, or are guilty of the wrongs, and there is no time or power to call a meeting of the stockholders, or because the majority of the stockholders are parties to or approve the wrongs, etc. Without such a showing as this, a bill or complaint by a stockholder, where the injury is to the corporation, is demurrable.²⁶

²⁵ *Atwool v. Merryweather*, L. R. 5 Eq. 464, note; *Menier v. Hooper's Telegraph Works*, 9 Ch. App. 350; *Mason v. Harris*, 11 Ch. Div. 97; *Pond v. Vermont Valley R. Co.*, 12 Blatchf. 280, Fed. Cas. No. 11265; *Decatur Mineral Land Co. v. Palm*, 113 Ala. 531, 21 So. 315, 59 Am. St. Rep. 140; *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320, 30 N. E. 667, 33 Am. St. Rep. 315; *Peabody v. Flint*, 6 Allen (Mass.) 52; *Rothwell v. Robinson*, 39 Minn. 1, 38 N. W. 772, 12 Am. St. Rep. 608; *Bjornsgaard v. Goodhue County Nat. Bank*, 49 Minn. 483, 52 N. W. 48; *Steitz v. Old Dominion Copper Mining & Smelting Co.*, 89 N. J. Eq. 265, 104 Atl. 214; *Robinson v. Smith*, 3 Paige

(N. Y.) 222, 24 Am. Dec. 212; *Wallace v. Lincoln Sav. Bank*, 89 Tenn. 630, 15 S. W. 448, 24 Am. St. Rep. 625; *Eschweiler v. Stowell*, 78 Wis. 316, 47 N. W. 361, 23 Am. St. Rep. 411.

²⁶ *Foss v. Harbottle*, 2 Hare 461; *Mozley v. Alston*, 1 Phil. Ch. 800; *Russell v. Wakefield Waterworks Co.*, L. R. 20 Eq. 474; *Dodge v. Woolsey*, 18 How. (U. S.) 331, 15 L. Ed. 401; *Hawes v. Oakland*, 104 U. S. 450, 26 L. Ed. 827; *Dimpfell v. Ohio & M. Ry. Co.*, 110 U. S. 209, 28 L. Ed. 121, 3 Sup. Ct. 573; *Brewer v. Boston Theatre*, 104 Mass. 378; *Dunphy v. Traveller Newspaper Ass'n*, 146 Mass. 495, 16 N. E. 426; *Soghomonian v. Garabedian*, 231 Mass. 445, 121 N. E.

It has been declared in some cases that a stockholder must not only demand of the directors that they institute suit, but that he must also apply to the stockholders as a body, that is at a stockholders' meeting.²⁷ Such an application to the stockholders seems impractical and superfluous. Ordinarily the stockholders cannot give orders to the directors or control their discretion. The remedy of electing other directors involves fatal delay and difficulty. The only possible utility of such a requirement is in cases where the majority might have a discretion to ratify some voidable transaction.²⁸

A stockholder cannot sue to set aside a transaction on the part of the directors on the ground that it was fraudulent, irregular, illegal, or voidable by the corporation, where the transaction is such as a majority of the stockholders may ratify, unless, as may sometimes be the case, it is impossible to procure a meeting of the stockholders to pass upon the transaction. This principle was applied in *Foss v. Harbottle*, a leading English case, where stockholders sued to set aside a purchase by the directors for the corporation of their own land at an excessive price. It was held that, while the transaction might be avoided by the corporation, it might also be ratified by a majority of the stockholders, and that the suit, therefore, could not be maintained without showing that no action of the stockholders could be obtained. "Whilst the court," said Vice Chancellor Wigram, "may be declaring the acts complained of to be void at the suit of the present plaintiffs, who in fact may be the only proprietors who disapprove of them, the governing body of proprietors may defeat the decree by lawfully resolving upon the confirmation of the very acts which are the subject of the suit. The very fact that the governing body of proprietors as-

401; *Moore v. Lewisburg & R. E. R. Co.*, 80 W. Va. 653, 93 S. E. 762, L. R. A. 1918 A 1028.

²⁷ *Mozley v. Alson*, 1 Phil. Ch. 800; *Foss v. Harbottle*, 2 Hare 461; *Kessler v. Ensley Co.*, 123 Fed. 546; *Hawes v. Oakland*, 104 U. S. 450, 26 L. Ed. 827; *Rathbone v. Parkersburg Gas Co.*, 31 W. Va. 798, 8 S. E. 570; *Doud v. Wisconsin, P. & S. Ry. Co.*, 65 Wis. 108, 25 N. W. 533, 56 Am. Rep. 620; *Dunphy v. Travelers' Newspaper Ass'n*, 146 Mass. 495, 16 N. E. 426; *Ward v. Hotel Randolph Co.*, 65 W. Va. 721, 63 S. E. 613; *Holmes v. Jewett*, 55 Colo. 187, 134 Pac. 665; *Allen v. Montana Refining Co.*, 71

Mont. 105, 227 Pac. 582, 587; 14 C. J. 943, 944.

²⁸ Demand on the stockholders is not necessary where their action would not govern the board of directors. *In re Kohler*, 231 N. Y. 353, 132 N. E. 114. See *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 17, 99 N. E. 138, 51 L. R. A. (N. S.) 112, Ann. Cas. 1914 A 777, note, on necessity of applying to body of stockholders as a condition of right of stockholder to sue on behalf of the corporation; *Delaware & H. Co. v. Albany & S. R. Co.*, 213 U. S. 435, 53 L. Ed. 862, 29 Sup. Ct. 540.

sembled at the special general meeting may so bind even a reluctant minority, is decisive to show that the frame of this suit cannot be sustained whilst that body retains its functions. In order then that this suit may be sustained, it must be shown either that there is no such power as I have supposed remaining in the proprietors, or, at least, that all means have been resorted to and found ineffectual to set that body in motion."²⁹

In this case of *Foss v. Harbottle*, however, it appears that the charter was peculiar in that the directors were subject to the superior control of the stockholders, who had power to originate proceedings themselves as well as to control the directors. But where the stockholders have no power to control the directors or to institute suit or to ratify the transaction, refusal by the directors ought to be sufficient to show a default by the corporation in enforcing its rights, without application to the stockholders. It has been so decided by the New York court in an action for account of capital stock alleged to have been fraudulently given to two of the directors.³⁰

Excuse from demand on directors or stockholders.—A request or demand upon the directors or majority of the stockholders to bring suit or take other steps to obtain relief need not be made by a stockholder before bringing a representative suit, if the circumstances are such as to clearly show that it would be a mere useless form. No such request or demand is necessary, therefore, as a general rule, where the wrong complained of was done or is threatened by a majority of the stockholders, or by the directors with the consent or approval of a majority of the stockholders, or by an officer who himself owns a majority of the stock.³¹ In such

²⁹ *Foss v. Harbottle*, 2 Hare 461. See also, *Brewer v. Boston Theatre*, 104 Mass. 378; *Bill v. Western U. Tel. Co.*, 16 Fed. 14.

³⁰ *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112, Ann. Cas. 1914 A 777. See 4 Cook, Corporations (8th Ed.), sec. 740.

³¹ *Delaware & H. Co. v. Albany & S. R. Co.*, 213 U. S. 435, 53 L. Ed. 862, 29 Sup. Ct. 540; *Rogers v. Nashville, C. & St. L. Ry. Co.*, 91 Fed. 299; *Green v. Hedenberg*, 159 Ill. 489, 42 N. E. 851, 50 Am. St. Rep. 178; *Brewer v. Boston Theatre*, 104 Mass. 378; *Blair v. Telegram News-*

paper Co., 172 Mass. 201, 51 N. E. 1080; *Rothwell v. Robinson*, 39 Minn. 1, 38 N. W. 772, 12 Am. St. Rep. 608; *Pencille v. State Farmers' Mut. Hail Ins. Co.*, 74 Minn. 67, 76 N. W. 1026, 73 Am. St. Rep. 326; *Knoop v. Bohmrich*, 49 N. J. Eq. 82, 23 Atl. 118; *Bohmrich v. Knoop*, 50 N. J. Eq. 485, 27 Atl. 636; *Eschweiler v. Stowell*, 78 Wis. 316, 47 N. W. 361, 23 Am. St. Rep. 411; *Atwool v. Merryweather*, L. R. 5 Eq. Cas. 464n. A bill was sustained by members of a corporation against the corporation and two of the directors, and without a request to sue, upon the ground that a majority of the shares were under

a case the principle of the case of *Foss v. Harbottle* has no application. Nor does it apply in case an injunction is sought against an *ultra vires* transaction which the majority cannot ratify.

The courts are strict, however, in requiring a proper demand upon the corporation to sue or a specific showing of sufficient excuse therefrom. If the bill of complaint alleges such abuse of authority and duty by the directors in misappropriating or diverting the corporate property as cannot be ratified or remitted by the corporation, or that some of the defendants own or control a majority of the stock, this shows that application to the stockholders or directors for redress would be futile and unnecessary.³² The requirement of seeking redress of the corporation itself is not excused by an allegation that one of the directors who is a party defendant controls the majority of the stock, and elects such board as he may choose, but with no averment of fraud or misconduct on the part of the other directors in the wrongful management of the corporation. It could not be presumed that the directors would refuse to do their duty if their attention were called to it.³³ The

the control of the parties charged with the fraud against the corporation. At a stockholders' meeting a majority of the shares voted to ratify the contract, but without the shares of the beneficiaries of the fraud the majority was the other way. See *Rogers v. Nashville, C. & St. L. Ry. Co.*, 91 Fed. 299, 308.

In *Morton v. Morton Realty Co.*, 41 Idaho 729, 241 Pac. 1014, 1015, it is said: "Primarily the corporation is the party to proceed in such cases to redress wrongs to the corporation, but a stockholder may institute such an action without demand on the corporation, where such demand would be futile or useless on the theory that the offending parties would be unlikely to start proceedings against themselves. *Ryan v. Old Veteran Min. Co.*, 37 Idaho 625, 218 Pac. 381; *Just v. Idaho Canal & Improvement Co.*, 16 Idaho 639, 102 Pac. 381, 133 Am. St. Rep. 140; *Forbes v. Wilson*, 243 Fed. 264; *Robinson v. De Luxe Motor Car Co. of New Jersey*, 170 Mich. 163, 135 N. W. 897; *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 Atl. 645; *Tasler v. Peerless Tire Co.*, 144 Minn. 150, 174 N. W. 731; *Heath v. Erie Ry. Co.*, 11 Fed. Cas. 976; *Glenn v. Kittanning Brewing Co.*, 259 Pa. 510, 103

Atl. 340, L. R. A. 1918 D 738, Ann. Cas. 1918 D 769." See also, *Wilson v. Brown*, 269 Pa. 225, 112 Atl. 1.

³² *Brewer v. Boston Theatre*, 104 Mass. 378. See *Shaw v. Staight*, 107 Minn. 152, 119 N. W. 951, 20 L. R. A. (N. S.) 1077; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112, Ann. Cas. 1914 A 777.

In *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030, 1037, plaintiff stockholders constituted a majority of the board of directors at time suit was filed against the corporation and fraudulent promoters. But if they had sued in the name of the corporation, the defendants who controlled a large majority of the stock would speedily have held a stockholders' meeting and suppressed the proceeding. Plaintiffs were seeking to secure relief for the wrong done to the corporation which could not be obtained through corporate action.

³³ *Dunphy v. Travelers' Newspaper Ass'n*, 146 Mass. 495, 16 N. E. 426. See *Bartlett v. New York, N. H. & H. R. Co.*, 221 Mass. 530, 532, 109 N. E. 452; *Corbus v. Alaska Treadwell Gold Min. Co.*, 187 U. S. 455, 47 L. Ed. 256, 23 Sup. Ct. 157; *Wathen v. Jackson Oil & Refining Co.*, 235 U.

plaintiff must plead the facts essential to show that relief cannot be obtained through the usual corporate channels. Where a corporation has ceased to appoint officers, and has abandoned its business, a stockholder may sue for himself and others for the protection of their rights, without showing or alleging a refusal of corporate officers to act.³⁴

§ 190. Discretionary powers of directors or majority of the stockholders.

The doctrine that a stockholder may sue in equity to redress or prevent wrongs on the part of the directors or majority of the stockholders, or for injuries by strangers, where he cannot obtain relief through the corporation, does not give a stockholder the right to maintain such a bill where the act complained of, or the refusal of the directors or majority of the stockholders to sue, is properly within the discretionary power with respect to the management of the internal affairs of the corporation. So long as they act, not fraudulently, illegally, or oppressively, but in good faith, in the honest exercise of their discretion, and for what they deem to be the best interests of the company, a court of equity has no jurisdiction to interfere at the suit of a dissenting stockholder, or a dissenting minority of the stockholders. Such a suit cannot be maintained by showing a mere mistake or error of judgment on the part of the directors or majority of the stockholders. Their conduct must be *ultra vires*, negligent, illegal, fraudulent, oppressive or a palpable abuse of discretion.³⁵ "In cases involving no breach of trust, but only error or mistake of judgment upon the part of the directors who represent the company, individual stock-

S. 635, 639, 59 L. Ed. 395, 35 Sup. Ct. 225.

³⁴ *Crumlish's Adm'r v. Shenandoah Val. R. Co.*, 28 W. Va. 623. See *Donnelly v. Sampson*, 135 Wis. 368, 115 N. W. 1089; *Fletcher, Corporations*, sec. 4070. See also, *Klein v. Peter*, 284 Fed. 797, 29 A. L. R. 1497. If a corporation is in the hands of a receiver a stockholder cannot sue without the sanction of the court, as the authority of the receiver to protect the interests of the corporation is exclusive.

³⁵ *Foss v. Harbottle*, 2 Hare 461; *MacDougall v. Gardiner*, 1 Ch. Div. 13; *Dudley v. Kentucky High-School*, 9 Bush (Ky.) 576; *Dunphy v. Trav-*

lers' Newspaper Ass'n, 146 Mass. 495, 16 N. E. 426; *Sewell v. East Cape May Beach Co.*, 50 N. J. Eq. 717, 25 Atl. 929; *Ellerman v. Chicago Junction Rys. & Union Stockyards Co.*, 49 N. J. Eq. 217, 23 Atl. 287; *Leslie v. Lorillard*, 110 N. Y. 519, 18 N. E. 363, 1 L. R. A. 456; *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818, L. R. A. 1915 D 632.

It has even been held in one extreme decision that a majority of the stockholders may in effect ratify an actual fraud by a director, if they act in good faith, against the protest of the minority. *Kessler v. Ensley Co.*, 123 Fed. 546,

holders have no right to appeal to the courts to dictate the line of policy to be pursued by the corporation.”³⁶

In *United Copper Securities Co. v. Amalgamated Copper Co.*,³⁷ Brandeis, J., says: “Whether or not a corporation shall seek to enforce in the courts a cause of action for damages, is like other business questions, ordinarily a matter of internal management and is left to the discretion of directors, in the absence of instructions by vote of the stockholders. Courts interfere seldom to control such discretion *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment; and as a rule only after application to the stockholders, unless it appears that there was no opportunity for such application, or that such application would be futile (as where wrongdoers control the corporation), or that the delay involved would defeat recovery.”

Refusal to sue.—The mere fact that a corporation has a cause of action for an injury committed by officers or third parties does not always make it incumbent upon it to sue, any more than in the case of an individual. If, in the honest opinion of the directors the best interests of the company do not require it to sue, it need not do so. The matter is within their discretion, and, if they act in good faith, their refusal to sue violates no right of dissenting stockholders, so as to entitle them to maintain a suit in their own behalf.³⁸

“It would be contrary to the fundamental principles of corporate organization,” said Judge Knowlton in a Massachusetts case, “to hold that a single shareholder can at any time launch the corporation into litigation to obtain from another what he deems to be due to it, or to prevent methods of management which he thinks unwise. Intelligent and honest men differ upon questions of business policy. It is not always best to insist upon all one’s rights; and a corporation acting by its directors, or by vote of its members, may properly refuse to bring a suit which one of its stockholders

³⁶ *Dudley v. Kentucky High-School*, 9 Bush (Ky.) 576; *Rice v. Thomas*, 184 Ky. 168, 211 S. W. 428; *Venner v. Southern Pac. Co.*, 279 Fed. 832.

³⁷ 244 U. S. 261, 264, 61 L. Ed. 1119, 37 Sup. Ct. 509. See *Macdougall v. Gardiner*, 1 Ch. Div. 13.

³⁸ *United Copper Securities Co. v.*

Amalgamated Copper Co., 244 U. S. 261, 61 L. Ed. 1119, 37 Sup. Ct. 509; *Post v. Buck’s Stove & Range Co.*, 200 Fed. 918, 43 L. R. A. (N. S.) 498 (settlement of litigation by directors in good faith is binding on minority).

believes should be prosecuted. In such a case the will of the majority must control. It is only when the action of a corporation in refusing to proceed at the request of a stockholder is fraudulent as against him, or in disregard of his rights, that he can maintain a suit in his own name in the corporate right. The court cannot interfere with the management of corporations in matters which are properly within their discretion, so long as their discretion is fairly exercised, and it is always assumed until the contrary appears, that they and their officers obey the law, and act in good faith towards all their members."³⁹

Good faith, however, is not the only limitation upon the discretion of the directors, according to the better opinion. The usual test now is whether the directors acted not only honestly but within the bounds of an intelligent business judgment or discretion.⁴⁰ Where bank directors refuse to resist the payment of a tax which is conceded to be illegal, but the payment of which the directors consider it inadvisable to resist, this cannot be said to be due to a mere error of judgment, but is a neglect or disregard of duty, and a stockholder may file a bill to restrain its collection.⁴¹

§ 190a. Persons entitled to sue as stockholders.

In order that a person may maintain a suit as a stockholder to set aside or enjoin an *ultra vires* transaction, or to redress or prevent other injuries to the corporation, he must be a stockholder in fact when the suit is brought. If he has ceased to be a stockholder by reason of a transfer of his shares, he has no standing to complain.⁴² It is not sufficient that a person be a director or officer, as the corporation owes the obligation to assert its rights to the stockholders, and the officer under some statutes is not necessarily a stockholder.⁴³ Such a suit may be brought by an ad-

³⁹ Dunphy v. Travelers' Newspaper Ass'n, 146 Mass. 495, 16 N. E. 426.

⁴⁰ Groel v. United Elec. Co. of New Jersey, 70 N. J. Eq. 616, 61 Atl. 1061. Cp. Chambers v. Chambers & McKee Glass Co., 185 Pa. St. 105, 39 Atl. 822.

⁴¹ Dodge v. Woolsey, 18 How. (U. S.) 331, 15 L. Ed. 401. The right of the stockholder to sue in event of default by the corporation in seeking to protect its rights was first fully admitted and established in this case in 1855.

⁴² Doyle v. Munz, 5 Hare 509; Scanlan v. Snow, 2 App. D. C. 137; Bussey v. Hooper, 35 Md. 15, 6 Am. Rep. 350; Thompson v. Stanley, 73 Hun (N. Y.) 248, 25 N. Y. Supp. 890; Fitchett v. Murphy, 46 N. Y. App. Div. 181, 61 N. Y. Supp. 182, rev'g 26 N. Y. Misc. Rep. 544, 56 N. Y. Supp. 322; Hanna v. Lyon, 179 N. Y. 107, 71 N. E. 778; Schultze v. Van Doren, 64 N. J. Eq. 465, 53 Atl. 815.

⁴³ Wright v. Floyd, 43 Ind. App. 546, 86 N. E. 971.

ministrator or executor having the title to shares as such, or by any person holding shares in trust;⁴⁴ or by a *cestui que trust* of shares, if the trustee refuses to sue, and is made a party defendant,⁴⁵ or by a pledgee of shares,⁴⁶ or by the pledgor.⁴⁷ Even an equitable owner may maintain a stockholder's action. It is not necessary to allege that the plaintiff is a stockholder of record.⁴⁸

Creditors.—It has been asserted that depositors of a bank may bring a representative suit on behalf of the corporation to enforce a corporate right of action against its officers for negligent and wrongful acts causing loss to the corporation, in order to realize corporate assets for distribution among its creditors and then among its stockholders. But it would seem that simple contract creditors could not maintain such a suit and that judgment creditors would sue on the theory of a creditor's bill to reach assets.⁴⁹

Subsequent transferees.—In the federal courts a stockholder cannot sue in equity to set aside or enjoin an *ultra vires* transaction, or redress a misapplication of corporate assets, or to enjoin or obtain redress for fraud or negligence on the part of the directors or other shareholders, etc., unless he was a stockholder at the time of the transactions complained of, or his shares have devolved upon him since by operation of law;⁵⁰ and the same rule has been asserted in several states upon the authority of the decisions of the Supreme Court of the United States.⁵¹ The decisions

⁴⁴ Scanlan v. Snow, 2 App. D. C. 137; Jones v. Pearl Min. Co., 20 Colo. 417, 38 Pac. 700.

⁴⁵ Great Western Ry. Co. v. Rushout, 5 De Gex & S. 290. This may be explained as enforcing specific performance of the duty of the trustee to sue to compel the corporation to perform its duty to him as stockholder of record to assert its right of action against some third party.

⁴⁶ Campbell v. American Zylonite Co., 122 N. Y. 455, 25 N. E. 853, 11 L. R. A. 596; Chafee v. Quidnick Co., 14 R. L. 75; Baldwin v. Canfield, 26 Minn. 43, 1 N. W. 261, 276; Green v. Hedenberg, 159 Ill. 489, 42 N. E. 851, 50 Am. St. Rep. 178.

⁴⁷ Fisher v. Patton, 134 Mo. 32, 33 S. W. 451, 34 S. W. 1096.

⁴⁸ Security Trust Co. of Rochester v. Pritchard, 190 N. Y. Supp. 871,

aff'd 201 N. Y. App. Div. 142, 194 N. Y. Supp. 486.

⁴⁹ Browne v. Hammett, 133 S. O. 446, 141 S. E. 612; Boyd v. Mutual Fire Ass'n, 116 Wis. 155, 90 N. W. 1086, 94 N. W. 171, 61 L. R. A. 918, 96 Am. St. Rep. 948; 14 A. C. J. p. 191. See Interstate Refining Co. v. Barry, 7 Fed. (2d) 548; Security Trust Co. v. Pritchard, 201 N. Y. App. Div. 142, 194 N. Y. Supp. 486; Land Title & Trust Co. v. Connolly, 233 Pa. 1, 81 Atl. 903.

⁵⁰ Post, § 193.

⁵¹ Alexander v. Searcy, 81 Ga. 536, 8 S. E. 630, 12 Am. St. Rep. 337; Boldenweck v. Bullis, 40 Colo. 253, 90 Pac. 634; Clark v. American Coal Co., 86 Iowa 436, 53 N. W. 291, 17 L. R. A. 557; Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N. W. 1024, 60 L. R. A. 927, 108 Am. St. Rep.

in the federal courts, however, are not based upon any general principle, but upon the equity rule of court adopted by the supreme court, and which was designed as a rule of practice merely, to guard those courts against collusion of parties for the purpose of bringing cases within their jurisdiction.⁵²

By the weight of authority, in the absence of such a rule of court, a stockholder is not precluded from suing in equity on behalf of himself and other stockholders by the mere fact that he purchased his shares after the transactions complained of, even though he may have known of them at the time of his purchase, and though he may have made the purchase for the purpose of acquiring a standing to sue, for the transfer of stock not only conveys to the transferee the ownership of the shares and the right to the future dividends thereon, but also places him upon an equal footing with the other stockholders—provided neither he nor his transferrer is otherwise estopped—in respect to the right to call the officers and agents of the corporation to account, or to compel the corporation to assert its rights of action against third parties.⁵³ A stockholder may sue in equity in most state courts, in a proper case, to set aside an *ultra vires* transaction, or obtain redress for a misapplication of corporate assets, notwithstanding he purchased his shares and became a stockholder after the transactions of which he complains and notwithstanding he knew of the transactions at the time of his purchase.⁵⁴

716; *Moore v. Silver Valley Min. Co.*, 104 N. C. 534, 10 S. E. 679; *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 Atl. 645.

Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N. W. 1024, 60 L. R. A. 927, 108 Am. St. Rep. 716, per Pound, C.: "The right of the stockholder to sue exists because of special injury to him for which otherwise he is without redress." If he was not a stockholder at the time, he was not injured by mismanagement. He cannot sue in equity, because he has acquired the shares of a person injured by past transactions, which have no present effect on the value of his stock.

⁵² 1 *Morawetz, Priv. Corp.*, § 269; *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788; *North v. Union Savings & Loan Ass'n*, 59 Ore. 483, 117 Pac. 822.

Right of stockholder, suing in behalf of a corporation to complain of misdeeds occurring prior to his ac-

quisition of stock, see *Seasegood*, 21 *Harvard Law Rev.* 195.

⁵³ *Seaton v. Grant*, 2 Ch. App. 459; *Bloxam v. Metropolitan Ry. Co.*, 3 Ch. App. 337; *Winsor v. Bailey*, 55 N. H. 218; *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788; *Carson v. Iowa City Gas-Light Co.*, 80 Iowa 638, 45 N. W. 1068; *Elkins v. Camden & A. R. Co.*, 36 N. J. Eq. 5; *Pollitz v. Gould*, 202 N. Y. 11, 94 N. E. 1088, 38 L. R. A. (N. S.) 988, *Ann. Cas.* 1912 D 1098; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112, *Ann. Cas.* 1914 A 777. But see *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N. W. 1024, 60 L. R. A. 927, 108 Am. St. Rep. 716; *Roberson v. Draney*, 53 Utah 263, 178 Pac. 35.

⁵⁴ *Winsor v. Bailey*, 55 N. H. 218; *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788; *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112, *Ann. Cas.*

It is clear, however, that a person who purchases shares in a corporation with knowledge of the fact that his transferrer is estopped, by laches, participation, or acquiescence, to complain of a previous *ultra vires* transaction or misapplication of funds, is in precisely the same position as his transferrer, and is also estopped.⁵⁵ And the weight of authority is that a transferee of shares is in the same position as his transferrer with respect to suing on account of transactions prior to the transfer, even when he is a purchaser without notice; and that he is estopped to sue, therefore, without regard to his good faith, if his transferrer was estopped.⁵⁶

It has been held, however, in New York,⁵⁷ that the liability of the former owner of the stock for negligence as director causing loss to the corporation does not estop the transferee from pursuing his remedy, even though his stock is purchased subsequent to the commission of the acts complained of. "Parties who deal in certificates of stock have long been protected by law upon principles analogous to those that apply to commercial paper. Where stock is purchased in good faith it does not carry with it any taint, due to any negligence on the part of the former owner."

§ 191. Motive of stockholder in suing, and extent of his interest.

It is a general rule that, if a stockholder comes into a court of equity to enjoin or set aside *ultra vires* transactions on the part of the directors or a majority of the stockholders, or to obtain other relief for injuries to the corporation, and shows a right to relief, the court cannot properly inquire into his motive in prosecuting the suit.⁵⁸ It was said by Lord Chancellor Westbury in an Eng-

1914 A 777. Contra, *Alexander v. Searcy*, 81 Ga. 536, 8 S. E. 630, 12 Am. St. Rep. 337.

⁵⁵ *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788; *In re Syracuse, C. & N. Y. R. Co.*, 91 N. Y. 1; *Ffooks v. South Western Ry. Co.*, 1 Smale & G. 142.

The promoter and his transferees who take with knowledge of the fraud are estopped to require the corporation to bring suit. See *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 203 Mass. 159, 192, 193, 89 N. E. 193, 40 L. R. A. (N. S.) 314; *Stratton Massachusetts Gold Mines Co. v. Stratton*, 206 Mass. 117, 118, 92 N. E. 34.

⁵⁶ *Boldenweck v. Bullis*, 40 Colo. 253, 90 Pac. 634; *Parsons v. Hayes*,

14 Abb. N. C. (N. Y.) 419; *Babcock v. Farwell*, 245 Ill. 14, 91 N. E. 683, 137 Am. St. Rep. 284, 19 Ann. Cas. 74; *Clark v. American Coal Co.*, 86 Iowa 436, 53 N. W. 291, 17 L. R. A. 557; *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 Atl. 645. Contra, *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788; *Warren v. Robinson*, 25 Utah 205, 70 Pac. 989; note 16 Harvard Law Rev. 449.

⁵⁷ *Harris v. Pearsall*, 116 N. Y. Misc. 366, 190 N. Y. Supp. 61, 74; *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788.

⁵⁸ *Forrest v. Manchester, S. & L. Ry. Co.*, 4 De Gex, F. & J. 126; *Seaton v. Grant*, 2 Ch. App. 459; *Colman v. Eastern Counties Ry. Co.*, 10

lish case: "I have nothing to do with the motives of plaintiffs suing in this court. If they come here in a *bona fide* character, the reason for their coming here is a matter beyond the province of a court of justice to inquire into."⁵⁹ Thus a representative suit has been sustained where the plaintiff who had lost money speculating in shares of the corporation bought five shares solely for the purpose of filing the bill to attack certain gross frauds on the corporation by its manager in the hope that he would be bought off at a high price and so obtain compensation.⁶⁰ In a representative suit the aggregate interests of all the shareholders are the important thing, rather than the interest of the plaintiff. The stockholder must, however, sue in good faith for the company, and not as the mere puppet of a rival company. By the weight of authority, therefore, a suit by a stockholder on behalf of himself and other stockholders should be dismissed if it appears that he is suing solely in the interest of a rival corporation, in which he is also a stockholder, by its direction, and under an agreement by it to indemnify him for costs.⁶¹ This would almost make him the agent of an undisclosed principal and a suit professing to be the suit of a stockholder would be in reality the suit of the rival company.

When a stockholder sues to enjoin the directors of a corporation from applying its assets to purposes not authorized by its charter, or to prevent or redress other wrongs, his right to relief is not in any way affected by the fact that he holds little stock in the corporation, so that his share (in equity) of the amount which it is proposed to misapply, or the extent of his injury, is comparatively trivial. Notwithstanding this, he has the same right as the largest stockholder to insist that the assets of the corporation shall not be diverted from the objects for which it was created. The maxim,

Beav. 1; *Central R. Co. v. Collins*, 40 Ga. 582; *Elkins v. Camden & A. R. Co.*, 36 N. J. Eq. 5; *Pollitz v. Wabash R. Co.*, 150 N. Y. App. Div. 715, 135 N. Y. Supp. 789, aff'd 207 N. Y. 113, 100 N. E. 721; *Hodge v. United States Steel Corp.*, 64 N. J. Eq. 111, 53 Atl. 553, rev'g 64 N. J. Eq. 807, 54 Atl. 1. Compare however, *Sparhawk v. Union Passenger Ry. Co.*, 54 Pa. St. 401; *Clark v. American Coal Co.*, 86 Iowa 436, 53 N. W. 291, 17 L. R. A. 557.

⁵⁹ *Forrest v. Manchester, S. & L. Ry. Co.*, 4 De Gex, F. & J. 126.

⁶⁰ *Seaton v. Grant*, L. R. 2 Ch. App. 459. But see *Pitcher v. Lone Pine-Surprise Consol. Min. Co.*, 39 Wash. 608, 81 Pac. 1047; *Sayles v. Central Nat. Bank of Rome*, 18 N. Y. Misc. 155, 41 N. Y. Supp. 1063.

⁶¹ *Forrest v. Manchester, S. & L. Ry. Co.*, 4 De Gex, F. & J. 126. See also, *Waterbury v. Merchants' Union Exp. Co.*, 50 Barb. (N. Y.) 157; *Beshoar v. Chappell*, 6 Colo. App. 323, 40 Pac. 244. Compare, however, *Colman v. Eastern Counties Ry. Co.*, 10 Beav. 1; *Central R. Co. v. Collins*, 40 Ga. 582.

de minimis non curat lex, does not apply to *ultra vires* acts.⁶² But the smallness of the interest of the plaintiff may be considered in certain cases where the stockholder sues to compel the righting of wrongs to the corporation, and the suit is based upon the assertion of the company's claim against some third party.⁶³

§ 192. Laches and estoppel of stockholders.

Even when a stockholder would otherwise be entitled to maintain a suit in equity under the principles stated in the preceding sections, his right to relief may be barred by laches, or he may be estopped to complain by reason of acquiescence, consent, or participation in the acts complained of.

If a stockholder, with knowledge of wrongful acts on the part of the directors or a majority of the stockholders, stands by for an unreasonable time without taking any steps to set the same aside, and rights are acquired by others, his right to maintain a suit to set the transaction aside is barred by his laches, however clear his right to relief would have been if he had moved promptly.⁶⁴ The general rule is "that while a minority of the stockholders of a corporation may maintain a bill in equity in behalf of themselves and other stockholders, for fraud, conspiracy, or acts *ultra vires*, against a corporation, its officers and others who participate therein, when the minority stockholders have been injured or damaged by said acts, they must act promptly, and not wait an unreasonable length of time. If they postpone their complaint for an unreasonable time, they forfeit their right to equitable relief.

⁶² Tomkinson v. South-Eastern Ry. Co., 35 Ch. Div. 675; Seaton v. Grant, 2 Ch. App. 459; Elkins v. Camden & A. R. Co., 36 N. J. Eq. 5; Carver v. Southern Iron & Steel Co., 78 N. J. Eq. 81, 78 Atl. 240. Compare, Greenough v. Alabama Great Southern R. Co., 64 Fed. 22; Dannmeyer v. Coleman, 11 Fed. 97.

⁶³ Heinz v. National Bank of Commerce in St. Louis, 237 Fed. 942; Southern Pac. Co. v. Bogert, 250 U. S. 483, 63 L. Ed. 1099, 39 Sup. Ct. 533; Aldrich v. Union Bag & Paper Co., 81 N. J. Eq. 244, 87 Atl. 65; General Inv. Co. v. Bethlehem Steel Corp., 87 N. J. Eq. 234, 100 Atl. 347; Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N. W. 1024, 60 L. R. A. 927, 108 Am. St. Rep. 716. See General Inv. Co. v. Lake Shore & M. S. Ry. Co., 260 U. S. 261, 289, 67 L. Ed.

244, 43 Sup. Ct. 106; s. c., 269 Fed. 235.

⁶⁴ Houldsworth v. Evans, L. R. 3 H. L. 263; Dimpfell v. Ohio & M. Ry. Co., 110 U. S. 209, 28 L. Ed. 121, 3 Sup. Ct. 573; Alexander v. Searcy, 81 Ga. 536, 8 S. E. 630, 12 Am. St. Rep. 337; Peabody v. Flint, 6 Allen (Mass.) 52; Dunphy v. Travelers' Newspaper Ass'n, 146 Mass. 495, 16 N. E. 426; Rabe v. Dunlap, 51 N. J. Eq. 40, 25 Atl. 959: "A stockholder, who wants protection against the consequences of an *ultra vires* act, must ask for it with sufficient promptness to enable the court to do justice to him without doing injustice to others." He must not wait to see whether the act is likely to result in profit or loss and speculate upon the chances until the act of which he complains has become the foundation of rights or equities of others.

Nothing will call a court of equity into activity but conscience, good faith, and reasonable diligence. When these are wanting, the court is passive and does nothing." ⁶⁵

A stockholder who participates as an officer or as a stockholder in illegal or *ultra vires* transactions on the part of the directors or stockholders, or consents thereto, or who, with full knowledge of the intention to engage in such transactions, acquiesces therein, instead of objecting and taking steps to prevent the same, is estopped to afterwards sue in equity to set the transactions aside; and it can make no difference that he sues on behalf of himself and other stockholders, and that there are other stockholders who might maintain the suit.⁶⁶ The same is true where a stockholder expressly or by his conduct subsequently ratifies the transaction.⁶⁷

§ 193. Suits by stockholders in the federal courts.

It was settled in *Dodge v. Woolsey* in 1855 that, where the necessary diversity of citizenship exists, the federal courts have jurisdiction of a suit by a stockholder, on behalf of himself and other stockholders, to prevent or redress injuries to the corporation.⁶⁸

⁶⁵ *Alexander v. Searcy*, 81 Ga. 536, 8 S. E. 630, 12 Am. St. Rep. 337; *Southern Pac. Co. v. Bogert*, 250 U. S. 483, 63 L. Ed. 1099, 39 Sup. Ct. 533. Laches is acquiescence in the alleged wrong or lack of diligence in seeking a remedy in addition to lapse of time. If others representing the minority as a class have been diligent, it is not essential that all those defrauded should intervene.

⁶⁶ *Pigeon River Ry. Co. v. Champion Fibre Co.*, 280 Fed. 557; *Burt v. British Nation Life Assur. Ass'n*, 4 De Gex & J. 158; *Dimpfell v. Ohio & M. Ry. Co.*, 110 U. S. 209, 28 L. Ed. 121, 3 Sup. Ct. 573; *McGeorge v. Big Stone Gap Improvemnt Co.*, 57 Fed. 262; *Post v. Beacon Vacuum Pump & Electrical Co.*, 84 Fed. 371; *Memphis & C. R. Co. v. Grayson*, 88 Ala. 572, 7 So. 122, 16 Am. St. Rep. 69; *Parsons v. Joseph*, 92 Ala. 403, 8 So. 788; *Dunphy v. Travelers' Newspaper Ass'n*, 146 Mass. 495, 16 N. E. 426; *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617; *Rabe v. Dunlap*, 51 N. J. Eq. 40, 25 Atl. 959; *Parsons v. Hayes*, 14 Abb. N. C. (N. Y.) 419; *Burden v. Burden*, 159 N. Y. 287, 54 N. E. 17.

⁶⁷ *Cozart v. Georgia Railroad &*

Banking Co., 54 Ga. 379; *Berry v. Broach*, 65 Miss. 450, 4 So. 117; *Fredericks v. Pennsylvania Canal Co.*, 109 Pa. St. 50, 2 Atl. 48; *Wormser v. Metropolitan St. R. Co.*, 184 N. Y. 83, 76 N. E. 1036, 112 Am. St. Rep. 596, 6 Ann. Cas. 123; *Towers v. African Tug Co.*, L. R. [1904] 1 Ch. Div. 558. A shareholder who, with full knowledge of the facts, himself received part of the proceeds of an *ultra vires* act committed by the directors—such as payment of a dividend out of capital—and who still retains the money, cannot either individually or suing on behalf of the general body of shareholders, maintain an action against the directors to compel them to repay the amount to the company.

⁶⁸ 18 How. (U. S.) 331, 15 L. Ed. 401; *Hill v. Wallace*, 259 U. S. 44, 66 L. Ed. 822, 42 Sup. Ct. 453; *Greenwood v. Union Freight R. Co.*, 105 U. S. 13; *Barnes v. Kornegay*, 62 Fed. 671.

The complaining stockholder must hold stock of the value of \$3,000. *Carpenter v. Knollwood Cemetery*, 198 Fed. 297; *Clauss v. Palmer Union Oil Co.*, 213 Fed. 286; *In re Cleland*, 218 U. S. 120, 54 L. Ed. 962, 30 Sup. Ct. 647.

It became a practice in order to get such cases into the federal courts, either to have a nonresident stockholder sue the corporation, or if there was no nonresident stockholder, to have a few shares transferred to a nonresident who would, upon refusal of the board of directors to act, bring suit in the federal courts. In the case of *Hawes v. Oakland*, Justice Miller strongly condemned this practice as an imposition.⁶⁹

Shortly after this decision, Equity Rule 94 (new Equity Rule 27), was adopted by the Supreme Court of the United States for the purpose of guarding against collusion of parties for the purpose of bringing cases within the jurisdiction of such courts. This rule is as follows: "Every bill brought by one or more stockholders in a corporation, against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action." There are now added the words "or the reasons for not making such effort."

Under this rule a bill is demurrable if it fails to allege that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share has since devolved upon him by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it would otherwise have no cognizance.⁷⁰ It is also demurrable if it

Dodge v. Woolsey, decided in 1855, was a suit for an injunction brought by Woolsey, a citizen of Connecticut and a stockholder in an Ohio bank against the bank, its directors and one Dodge, a state tax collector, to prevent the bank from paying and the collector from receiving the tax on the ground that the tax would violate the obligation of the contract concerning taxation found in the charter of the bank. The Supreme Court held that the failure of the directors to resist the tax, which would destroy the bank, was not

merely an error of judgment, but a breach of duty, and that the federal court had jurisdiction on the ground of diversity of citizenship.

⁶⁹ 104 U. S. 450, 26 L. Ed. 827; *Dimpfell v. Ohio & M. Ry. Co.*, 110 U. S. 209, 28 L. Ed. 121, 3 Sup. Ct. 573. See 21 *Harvard Law Rev.* 195, 199, *Seasongood*, Right of a stockholder suing in behalf of a corporation to complain of misdeed occurring before his acquisition of stock.

⁷⁰ *O'Brien v. Lashar*, 274 Fed. 326; *Fletcher, Corporations*, sec. 4069.

fails to show with particularity, as required by the rule, efforts on the part of the plaintiff to secure action by the directors or trustees, or the shareholders, and the causes of his failure to obtain such action, so as to show a right to sue.⁷¹ It is not necessary, however, that it shall show a request upon the directors or other shareholders to sue or take other action, if it shows that they are the parties guilty of the wrongs complained of, or that, for any other reason, such a request would have been useless; but it must particularly set forth the facts excusing failure to make such a request.⁷²

§ 194. Intervention or defense by stockholder in pending suit.

If a corporation is suing or being sued, the management of the suit is within the honest discretion of the directors. If they abuse their discretion by failing to prosecute or defend the action in good faith, the stockholder may be able to intervene and assert the rights or defenses of the corporation. To intervene for the protection of the corporation the stockholder must show effort to procure action by the corporation or that such effort would be useless.⁷³ This is the case when suit is brought against a corporation by one who holds a majority of the stock, or otherwise controls the directors, and the suit is conducted fraudulently in his own interest, and against the interest of the corporation and the minority of stockholders; or in any other case in which a corporation or its

⁷¹ Dodge v. Woolsey, 18 How. (U. S.) 331, 15 L. Ed. 401; Delaware & H. Co. v. Albany & S. R. Co., 213 U. S. 435, 53 L. Ed. 862, 29 Sup. Ct. 540; Wathen v. Jackson Oil & Refining Co., 235 U. S. 635, 59 L. Ed. 395, 35 Sup. Ct. 225; United Copper Securities Co. v. Amalgamated Copper Co., 244 U. S. 261, 61 L. Ed. 1119, 37 Sup. Ct. 509.

⁷² Delaware & H. Co. v. Albany & S. R. Co., 213 U. S. 435, 53 L. Ed. 862, 29 Sup. Ct. 540; Interstate Refineries Inc. v. Barry, 7 Fed. (2d) 548, 552: "Request is dispensed with when the interests of the managing officers and directors are antagonistic to those of the corporation, its stockholders and creditors, and immediate action is imperative to preserve the property of the corporation and protect the stockholders from irretrievable loss. American Creosote Works, Inc. v. Powell, 298 Fed. 417, 420; Ogden v. Gilt Edge

Consol. Mines Co., 225 Fed. 723; Krouse v. Brevard Tannin Co., 249 Fed. 538; Heinz v. National Bank of Commerce in St. Louis, 237 Fed. 942; United Copper Securities Co. v. Amalgamated Copper Co., 244 U. S. 261, 61 L. Ed. 1119, 37 Sup. Ct. 509."

⁷³ A stockholder may defend a suit against the corporation if the directors are not defending the case properly. Shively v. Eureka Tellurium Gold-Min. Co., 129 Cal. 293, 61 Pac. 939; In re Eureka Anthracite Coal Co., 197 Fed. 216; Dickerman v. Northern Trust Co., 176 U. S. 181, 44 L. Ed. 423, 20 Sup. Ct. 311; Blake v. Blake & Knowles Steam Pipe Works, 8 N. J. Eq. 363, 94 Atl. 419; Fitzwater v. National Bank of Seneca, 62 Kan. 163, 61 Pac. 684, 84 Am. St. Rep. 377; Ogden v. Gilt Edge Consol. Mines Co., 225 Fed. 723; Gunderson v. Illinois Trust & Savings Bank, 199 Ill. 422, 65 N. E. 326. See 33 Yale Law Journal 581.

directors abuse their discretion in refusing to defend, or fail to prosecute the defense in good faith, and the stockholders cannot obtain relief within the corporation. In such cases, a stockholder, if the action is at law, may obtain relief by suing in equity, or if the suit is in equity, or under the code, a stockholder may intervene, and set up any defense which should properly be made by the corporation.⁷⁴ A fraudulent or collusive judgment permitted to be entered against a corporation may be opened up at the instance of stockholders to permit them to defend the action properly.⁷⁵

§ 195. Judgment or decree.

Where corporate funds have been misapplied, or other wrong done against the corporation, and suit is brought in equity by injured stockholders, the court may, by its decree, order the same relief as if the corporation had been plaintiff.⁷⁶ Direct relief to the stockholders cannot ordinarily be decreed, although it has been allowed in some exceptional cases in order that the decree may not place the undeserving upon an equality with the meritorious.⁷⁷

⁷⁴ *Waymire v. San Francisco & S. M. Ry. Co.*, 112 Cal. 646, 44 Pac. 1086; *Henry v. Traveler's Ins. Co.*, 16 Colo. 179, 26 Pac. 318; *Morrill v. Little Falls Mfg. Co.*, 46 Minn. 260, 48 N. W. 1124; *Bronson v. La Crosse & M. R. Co.*, 2 Wall. (U. S.) 283, 17 L. Ed. 725; *Farmers' Loan & Trust Co. v. Toledo, A. A. & N. M. Ry. Co.*, 67 Fed. 49; *State ex rel. Bugbee v. Holmes*, 60 Neb. 39, 82 N. W. 109.

⁷⁵ *Equitable Trust Co. of New York v. Denver & R. G. R. R.*, 269 Fed. 987; *Levy v. Equitable Trust Co. of New York*, 271 Fed. 49; *Atlantic Refining Co. v. Port Lobos Petroleum Corp.*, 280 Fed. 934; *National Power & Paper Co. v. Rossman*, 122 Minn. 355, 142 N. W. 818, Ann. Cas. 1914 D 830. If the directors dismiss an action through collusion with the defendant in order to defraud minority stockholders, in abuse of their duty to the corporation, the dismissal may be set aside at the instance of such stockholders and the action reinstated, when such course is necessary to protect their substantial rights. The directors must in good faith serve the interests of the stockholders.

⁷⁶ *Clark v. Arizona Mut. Savings & Loan Ass'n*, 217 Fed. 640; *Ebling*

v. Nekarda, 148 N. Y. App. Div. 193, 132 N. Y. Supp. 309; *Drucklieb v. Harris*, 84 N. Y. Misc. 291, 298, 147 N. Y. Supp. 298; *Voorhees v. Mason*, 245 Ill. 256, 91 N. E. 1056; *Chicago Macaroni Mfg. Co. v. Boggiano*, 202 Ill. 312, 67 N. E. 17; *Hayden v. Perfection Cooler Co.*, 227 Mass. 589, 116 N. E. 871. Decree must be for full amount of damages sustained by the corporation and money must be ordered paid to the corporation as if the suit had been brought by the corporation.

The fruits of the recovery go to the corporation and not to the stockholders personally. *Landis v. Sea Isle City Hotel Co.*, 53 N. J. Eq. 654, 33 Atl. 964; *Pollitz v. Wabash R. Co.*, 167 N. Y. App. Div. 669, 152 N. Y. Supp. 803; *Harris v. Pearsall*, 116 N. Y. Misc. 366, 190 N. Y. Supp. 61, 74, 78.

⁷⁷ Relief to stockholders instead of to corporation. *Von Arnim v. American Tube Works*, 188 Mass. 515, 74 N. E. 680 (semble); *Dill v. Johnston*, 72 Okla. 149, 179 Pac. 608 (corporation owned by two persons and majority holder converted all assets); *Eaton v. Robinson*, 19 R. I. 146, 31 Atl. 1058, 32 Atl. 339, 29 L. R. A. 100; *Brown v. De Young*, 167 Ill.

Judgment or decree as a bar.—When a stockholder brings a suit in equity in behalf of himself and other stockholders who may come in, to redress an injury to the corporation, making the corporation a party, as he must do, any judgment or decree rendered in the suit is clearly binding upon all who are parties to the suit,—the stockholder suing and other stockholders who actually come in and become parties, the corporation itself, guilty officers who are made parties defendant, and third persons who may have participated in the wrongs complained of, and who are made parties defendant. Further than this, the judgment or decree, unless collusive, being binding upon the corporation, which is the real party in interest, and which represents not only the stockholder suing, but all other stockholders as well, is conclusive against all the other stockholders, whether they avail themselves of their right to come in and be made parties, or not; and they cannot afterwards bring another suit for the purpose of litigating the same questions. “From the very form and nature of these suits, each stockholder must be considered as represented, for if he is in sympathy with the complainant he may become a party complainant by application to the court; if he is in sympathy with the threatened action of the company, he is represented by and in the corporation which is a necessary party to the suit. . . . Not only this, but the court may, if satisfied that the interests of the corporation are not being properly presented or protected, admit a stockholder to be made a party defendant.”⁷⁸

549, 47 N. E. 863; *Holmes v. Camp*, 180 N. Y. App. Div. 409, 167 N. Y. Supp. 840; *Joyce v. Congdon*, 114 Wash. 239, 195 Pac. 29. If plaintiff is the only stockholder in whose behalf the action can be maintained, it is proper to award him an individual judgment for the amount of his loss in the transaction. See *Tierney v. United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S. E. 249; *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 Atl. 645, 651. See also, ante, § 50, note 89, on theory of representative right to sue in corporate name against fraudulent promoters. 30 *Harvard Law Rev.* 39, 60.

In *Matthews v. Headley Chocolate Co.*, supra, it is said: “Some of the cases seem to go so far as to hold that where there is one innocent stockholder, in a suit in the name of the corporation, the whole amount found to be due must be recovered on the

principle apparently that ‘a little leaven leaveneth the whole lump,’ but we cannot apply that doctrine to a case like this,” viz., a suit to recover excessive salaries paid directors where the owners of three-fourths of the stock were estopped to complain. The only just beneficiaries of recovery were the minority.

⁷⁸ *Willoughby v. Chicago Junction Rys. & Union Stockyards Co.*, 50 N. J. Eq. 656, 25 Atl. 277; *Dana v. Morgan*, 219 Fed. 313, aff’d 232 Fed. 85; *Hearst v. Putnam Min. Co.*, 28 Utah 184, 77 Pac. 753, 66 L. R. A. 784, 107 Am. St. Rep. 698. Since the corporation has been compelled to perform its duty by bringing suit, it is the same situation as if the corporation had voluntarily sued, and the decree is conclusive for or against the corporate right of action which is the basis of the proceeding.

CHAPTER XVII.

LIABILITIES OF STOCKHOLDERS.

A. TO THE CORPORATION.

I. CALLS OR ASSESSMENTS ON UNPAID SUBSCRIPTIONS.

§ 196. In general.—If a subscription is in terms payable, not at a time or times certain, but as may be required by the directors or stockholders, a valid call is necessary to put a subscriber in default, and entitle the corporation to maintain an action against him, or forfeit or sell his shares; but no call is necessary when a subscription is payable at once, or at a fixed time in the future, or when it has been repudiated. A call is not valid unless made by the authority, and in the mode, prescribed by the charter, articles of association, or general law. In the absence of provision to the contrary, it is to be made by the board of directors. By the weight of authority, notice of a call is not necessary unless it is expressly required.

We shall consider in this chapter the various kinds of stockholders' liability, first to the corporation itself and then to its creditors and their representatives. *First*, is the right of the corporation to make calls upon stockholders for the unpaid balance of their subscriptions to stock; *second*, assessments by the corporation upon stock after the par value has been fully paid up; *third*, rights of creditors with respect to unpaid subscriptions; *fourth*, liability to creditors on watered stock where stock is issued for property at an overvaluation; *fifth*, liability of holders of stock issued without par value; *sixth*, the statutory liability of stockholders to creditors, under statutes imposing liability over and above the liability to pay the par value of their shares. The liabilities of those who issue and receive watered stock for fraud upon subsequent subscribers for stock and the remedies of the innocent stockholder as distinguished from those of the creditor are considered elsewhere.¹

¹ See ante, §§ 44a, 50, note 78.

The term "call," with reference to subscriptions to the capital stock of a corporation, is used in several senses. Ordinarily it is used merely to designate the resolution or declaration of the board of directors or other authority by which the whole or a part of unpaid subscriptions is made payable. It is also used to designate both this formal resolution or declaration, and the notice thereof or demand of payment, and other steps which may be required to render subscriptions payable, or to designate the time when the payment is due.^{1a} The term "assessment," with reference to unpaid subscriptions, means the same thing as the term "call," the two terms being often used interchangeably.² This term, however, is also used to designate payments required to be made by stockholders under statutory provisions over and above the par value of their shares, either to provide additional funds for the use of the corporation, or to pay creditors upon the insolvency of the corporation.³ While the term "call," therefore, is properly applied to unpaid subscriptions, the term "assessment" is applied both to unpaid and to full-paid stock.⁴

Whether or not a call is necessary to render a subscriber liable to an action on his subscription depends upon the terms of his contract of subscription, and the provisions of the charter of the corporation, general law, articles of association, and by-laws of the corporation, entering into and forming a part of his contract.

^{1a} See *Ambergate, Nottingham & B. & E. J. Ry. Co. v. Mitchell*, 4 Exch. 540; *Germania Iron Min. Co. v. King*, 94 Wis. 439, 69 N. W. 181, 36 L. R. A. 51.

² See *Budd v. Multnomah St. Ry. Co.*, 15 Ore. 413, 15 Pac. 659, 3 Am. St. Rep. 169; *Penobscot R. Co. v. White*, 41 Me. 512, 66 Am. Dec. 275; *Great Western Tel. Co. v. Burnham*, 79 Wis. 47, 47 N. W. 373, 24 Am. St. Rep. 698.

³ *Santa Cruz R. Co. v. Spreckles*, 65 Cal. 193, 3 Pac. 661, 802. See *Lum v. American Wheel & Vehicle Co.*, 165 Cal. 657, 133 Pac. 303.

In *Seyberth v. American Commander Mining & Milling Co.*, 42 Idaho 254, 245 Pac. 392, 395, the court says: "The word 'assessment' and the words 'call' or 'installments' are used interchangeably in the statute, yet, strictly speaking, the word 'assessment' means a demand upon stockholders for payments above the par value of their stock to meet

the money demands of creditors of the corporation; while the word 'call' or 'installments' means the action of the board of directors of the corporation demanding the payment of all or a portion of unpaid subscriptions. *Wall v. Basin Min. Co.*, 16 Idaho 313, 101 Pac. 733, 22 L. R. A. (N. S.) 1013. To the instant case the word 'assessment' properly applies. The levy and collection of assessments are statutory, and in this state the authority conferred upon the directors of a corporation to levy and collect assessments upon the subscribed capital stock, for the purpose of paying obligations, conducting business, or paying debts, is provided for by C. S. § 4733. Assessments must be impartial, equal and uniform to be valid, otherwise they are void."

⁴ *Santa Cruz R. Co. v. Spreckles*, 65 Cal. 193, 3 Pac. 661, 802; *Omo v. Bernart*, 108 Mich. 43, 65 N. W. 622.

No call is necessary when a subscription is payable, not upon call or demand by the directors or stockholders, but immediately, or on a specified day, or on or before a specified day, or when it is payable in instalments at specified times. In such cases it is the duty of the subscriber to pay the subscription or instalment thereof as soon as it is due, without any call or demand, and, if he fails to do so, an action may be brought at any time.⁵

Generally, however, subscriptions are not thus made payable immediately or at specified times, but are subject to call. If subscriptions are expressly or impliedly made payable upon call or demand by the directors or stockholders, either by the terms of the subscription paper itself, or by the charter of the corporation, or the general law, or articles of association, or by an authorized by-law adopted by the corporation prior to the subscription, a valid call by the directors or a majority of the stockholders, as the case may be, is a condition precedent to any liability on the subscription, and to the right of the corporation to maintain an action thereon.⁶ Calls must operate equally and proportionately upon all the stockholders, so that each will be required to pay the same amount on each share.⁷ If a subscriber repudiates his subscription, no call is necessary to render him liable to an action.⁸

Effect of transfer as novation.—In general where a stockholder makes a complete sale and transfer of his stock, and the transfer is duly registered, a novation or substitution is produced and the

⁵ *Spencer v. Anderson*, 193 Cal. 1, 222 Pac. 355, 35 A. L. R. 822, 832; *Horseshoe Pier Amusement Co. v. Sibley*, 157 Cal. 442, 108 Pac. 308; *New Albany & S. R. Co. v. McCormick*, 10 Ind. 499, 71 Am. Dec. 337; *Ruse v. Bromberg*, 88 Ala. 619, 7 So. 384; *Lake Ontario, A. & N. Y. R. Co. v. Mason*, 16 N. Y. 451; *Phoenix Warehousing Co. v. Badger*, 67 N. Y. 294; *Northwood Union Shoe Co. v. Pray*, 67 N. H. 435, 32 Atl. 770; *Myrtle Point Mill & Lumber Co. v. Clarke*, 102 Ore. 533, 203 Pac. 588.

⁶ *Geary St. P. & O. R. Co. v. Bradbury Estate Co.*, 179 Cal. 46, 175 Pac. 457; *San Bernardino County Sav. Bank v. Denman*, 186 Cal. 710, 200 Pac. 606; *Seymour v. Sturgess*, 26 N. Y. 134; *Braddock v. Philadelphia, M. & M. R. Co.*, 45 N. J. Law 363.

The necessity for calls when the corporation is insolvent and subscrip-

tions are enforced for the benefit of creditors is considered in a subsequent section. See post, § 199.

As respects subscriptions to stock, the statute does not begin to run from the time the subscription is made. It begins to run when a call is made and is due, and only as to such call. *Glenn v. Marbury*, 145 U. S. 499, 36 L. Ed. 790, 12 Sup. Ct. 914; *Hawkins v. Glenn*, 131 U. S. 319, 33 L. Ed. 184, 9 Sup. Ct. 739; *Glenn v. Liggett*, 135 U. S. 533, 34 L. Ed. 262, 10 Sup. Ct. 867. *Cook on Corporations* (8th Ed.), vol. 1, p. 613, sec. 195.

⁷ *Geary St. P. & O. R. Co. v. Bradbury Estate Co.*, 179 Cal. 46, 175 Pac. 457.

⁸ *Cass v. Pittsburg, V. & C. Ry. Co.*, 80 Pa. St. 31; *Shiffer v. Akenbrook*, 75 Ind. App. 149, 130 N. E. 241.

transferee is the one liable for future calls for the unpaid balance due on the stock. The stockholder's liability for unpaid subscriptions does not continue after he has transferred the stock, except when the transfer was made for the purpose of defrauding creditors. But if the transfer is made without consideration after the company has become insolvent this makes out a *prima facie* case of fraud upon creditors. By the weight of authority, when the corporation is insolvent, a transfer, in order that it may release the transferor from liability to or for the benefit of creditors for a balance due on the stock, or even to the corporation, must be made to a person who is legally capable of assuming liability.^{8a} A stockholder is not released from liability by a transfer to an infant, unless the latter becomes bound,^{8b} or to another corporation, unless it becomes bound,^{8c} or, by the weight of authority in this country, to a person known to be insolvent.^{8d} The American doctrine is that "a transfer of shares in a failing corporation, made by the transferor with the purpose of escaping his liability as a shareholder to a person who from any cause is incapable of responding in respect to such liability, is void as to creditors of the company and as to other shareholders, although as between the transferor and the transferee the transfer may be out and out."^{8e} A surrender of the stock to the corporation or its officers after it becomes insolvent is invalid against creditors.^{8f}

All of the courts agree that, when stock is issued as full-paid, or without anything on the certificates to show that it is not full-

^{8a} Capper's Case, 3 Ch. App. 458. See Butts v. King, 101 Conn. 291, 125 Atl. 654; 19 Illinois Law Rev. 368; Smith v. General Motors Corp., 289 Fed. 205.

^{8b} Capper's Case, 3 Ch. App. 458; Mann's Case, 3 Ch. App. 459n.

^{8c} See California Nat. Bank v. Kennedy, 167 U. S. 362, 42 L. Ed. 198, 17 Sup. Ct. 831; Knowles v. Sandercock, 107 Cal. 629, 40 Pac. 1047.

^{8d} In England it is held that a transfer, if out and out, and not merely colorable, discharges the transferor from any further liability, although made to a person known to be insolvent. Costello's Case, 2 De Gex F. & J. 302; De Pass' Case, 4 De Gex & J. 544; Harrison's Case, 6 Ch. App. 286; In re Discoverer's Finance Corp., [1908] 1 Ch. 141; note, 23 Harvard Law Rev. 566. But in this country the decisions are to the con-

trary. Nathan v. Whitlock, 9 Paige (N. Y.) 152; Aultman's Appeal, 98 Pa. St. 505; Wishard v. Hansen, 99 Iowa 307, 68 N. W. 691, 61 Am. St. Rep. 238; Welch v. Sargent, 127 Cal. 72, 59 Pac. 319.

^{8e} Aultman's Appeal, 98 Pa. St. 505; Burt v. Real Estate Exchange, 175 Pa. St. 619, 34 Atl. 923, 52 Am. St. Rep. 858; Wishard v. Hansen, 99 Iowa 307, 68 N. W. 691, 61 Am. St. Rep. 238; Sprague v. National Bank of America, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17.

^{8f} After a corporation becomes insolvent, a stockholder cannot escape liability for a balance due on his subscription by voluntarily assigning his certificate in blank, and delivering it to the treasurer of the corporation at his request. Burt v. Real Estate Exchange, 175 Pa. St. 619, 34 Atl. 923, 52 Am. St. Rep. 858.

paid,^{8g} purchasers have a right to rely upon the representation, unless they have notice that it is false. In such a case, therefore, *bona fide* purchasers are not liable for calls, either to the corporation or to creditors, if the shares are not in fact fully paid for.^{8h} This rule applies where watered stock is issued, and it is sought to hold transferees liable for the benefit of creditors of the corporation.⁸ⁱ If a transferee of watered or fictitiously paid-up stock has notice that it has not been fully paid, he is subject to the same liability thereon as his transferrer^{8j}

II. ASSESSMENTS UPON STOCKHOLDERS OR MEMBERS AFTER PAYMENT IN FULL.

§ 197. In general.—A corporation cannot levy an assessment upon the holders of full-paid stock, or, in the case of nonstock corporations, upon members who have paid all that is required by their contract of membership, unless the power to do so is conferred by the charter or articles of association or a valid statute, or by consent of the stockholders or members; and the legislature cannot authorize such an assessment, without the consent of the stockholders or members, by a statute passed after their rights are acquired, unless the power to alter, amend, or repeal the charter has been reserved.

We are to consider next the liability of stockholders to calls or assessments upon their shares after they have been in fact fully paid up, aside from the liability under statutes imposing liability for the benefit of creditors, and the right of nonstock corporations to levy assessments over and above the amount which the members have agreed to contribute.

It may happen that, when stockholders or members of a corporation have paid in full into the treasury of the corporation their

^{8g} West Nashville Planing-Mill Co. v. Nashville Sav. Bank, 86 Tenn. 252, 6 S. W. 340, 6 Am. St. Rep. 835, and other cases in the note following.

^{8h} Rood v. Whorton, 67 Fed. 434, aff'd 74 Fed. 118; West Nashville Planing-Mill Co. v. Nashville Sav. Bank, 86 Tenn. 252, 6 S. W. 340, 6 Am. St. Rep. 835; Brant v. Ehlen, 59 Md. 1; Coleman v. Howe, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; Sprague v. National Bank of America, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17.

⁸ⁱ Post, § 215 et seq.; Brant v. Eh-

len, 59 Md. 1; Coleman v. Howe, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; Sprague v. National Bank of America, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; and other cases above cited.

^{8j} Brant v. Ehlen, 59 Md. 1; Wallace v. Carpenter Electric Heating Mfg. Co., 70 Minn. 321, 73 N. W. 189, 68 Am. St. Rep. 530; Sprague v. National Bank of America, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; Wishard v. Hansen, 99 Iowa 307, 68 N. W. 691, 61 Am. St. Rep. 238.

required contributions to its capital stock or capital, so that their shares or membership are paid for in full, the corporation may have need of further funds. In such a case, the stockholders or members may undoubtedly contribute any additional sums they may choose. It is well settled, however, that they cannot be *compelled* to do so, unless additional liability is imposed by statute, or by the charter or articles of association. In the absence of a valid charter or statutory provision therefor, or an express agreement binding upon the stockholders, neither the board of directors nor a majority of the stockholders can levy and collect an assessment upon shares of stock which are fully paid for, whether the assessment is sought to be made for the purpose of raising money needed for the operations of the corporation, or for the purpose of paying its debts.⁹ And in the case of nonstock corporations, such as social clubs, boards of trade, and the like, when a member has contributed and paid all that the charter or articles of association require him to pay, he cannot be compelled to pay any further assessments, however much the additional funds may be needed.¹⁰ In many instances it may be wise and expedient for stockholders to make additional contributions of capital, so as to preserve the corporate property, or for the more successful conduct of the business. Statutes frequently give this power, particularly as to mining companies. In the case of banks and insurance companies such assessments may be authorized by statute when the capital becomes impaired.

The power to levy assessments after payment in full, unless otherwise conferred, cannot be given, as against dissenting stockholders or members, by a by-law passed by a majority of the stockholders or members.¹¹ Nor can the power be given by the legislature, as against existing members or stockholders who dis-

⁹ *Enterprise Ditch Co. v. Moffitt*, 58 Neb. 642, 79 N. W. 560, 76 Am. St. Rep. 122; *Kennebec & P. R. Co. v. Kendall*, 31 Me. 470; *Duluth Club v. MacDonald*, 74 Minn. 254, 76 N. W. 1128, 73 Am. St. Rep. 344; *Lancaster Starch Co. v. Moore*, 62 N. H. 671; *Atlantic Delaine Co. v. Mason*, 5 R. I. 463; *State v. Morristown Fire Ass'n*, 23 N. J. Law 195; *Trustees of Free Schools in South Parish in Andover v. Flint*, 13 Metc. (Mass.) 539; *Forstyth v. Selma Mines Co.*, 58 Utah 142, 197 Pac. 586. See *Warren, Safe-*

guarding rights of creditors, 36 Harvard Law Rev. 517.

¹⁰ *Duluth Club v. MacDonald*, 74 Minn. 254, 76 N. W. 1128, 73 Am. St. Rep. 344; *Omaha Law Library Ass'n v. Connell*, 55 Neb. 396, 75 N. W. 837.

¹¹ *Sullivan Country Club v. Butler*, 26 N. Y. Misc. 306, 56 N. Y. Supp. 1. See *Hibernia Fire Engine Co. v. Commonwealth*, 93 Pa. St. 264. Compare *Omaha Law Library Ass'n v. Connell*, 55 Neb. 396, 75 N. W. 837. See also, *Central Wisconsin Trust Co. v. Barter*, 194 Fed. 835.

sent, by an act passed after the formation of the corporation, where the power to alter or amend the charter has not been reserved, for this would be unconstitutional as impairing the obligation of contracts.¹² Of course, liability to assessment may be imposed by a statute in force at the time the corporation is formed, or by its charter, or by the articles of association, or otherwise by agreement at the time of becoming a member or stockholder, or afterwards.¹³ An agreement may be made between a corporation and its stockholders and embodied in the articles of incorporation and the stock certificates that the corporation will not exercise the right given by statute to levy assessments upon fully paid-up stock.¹⁴ But under some statutes this privilege against assessments must either be common to all the stockholders or else embodied in the articles.¹⁵

§ 198. Forfeiture or sale of shares.

A corporation has no power to forfeit or sell shares of its stock for nonpayment of assessments or calls, unless the power has been expressly conferred upon it by its charter or the general law, or by a provision in the articles of association, or otherwise by consent of the stockholders.¹⁶ In many jurisdictions a corporation may either sue to collect in case of failure to pay a call for a part or all of an unpaid subscription, or may sell the stock. The corporation has

¹² *Enterprise Ditch Co. v. Moffitt*, 58 Neb. 642, 79 N. W. 560, 76 Am. St. Rep. 122.

It has been held that such an act is constitutional where the state has reserved the power to alter or amend the charter of the corporation. *Gardner v. Hope Ins. Co.*, 9 R. I. 194, 11 Am. Rep. 238. But this is doubtful. See *Garey v. St. Joe Min. Co.*, 32 Utah 497, 91 Pac. 369, 12 L. R. A. (N. S.) 554. Compare *Sommerville v. St. Louis Mining & Milling Co.*, 46 Mont. 268, 127 Pac. 464, L. R. A. 1915 B 811; *Fletcher, Corporations*, secs. 4272, 4326.

¹³ *Mayberry v. Mead*, 80 Me. 27, 12 Atl. 635; *Dewey v. St. Albans Trust Co.*, 57 Vt. 332; *Atlantic Delaine Co. v. Mason*, 5 R. I. 463; *Wells v. Green Bay & M. Canal Co.*, 90 Wis. 442, 64 N. W. 69; *Weede v. Emma Copper Co.*, 58 Utah 524, 200 Pac. 586.

¹⁴ *Upton v. Trebilcock*, 91 U. S. 45, 23 L. Ed. 203 (marking of stock

"nonassessable" is only a stipulation against liability to future assessments after it is fully paid up. It is no defense to an action for the unpaid balance of the par value); *Lum v. American Wheel & Vehicle Co.*, 165 Cal. 657, 133 Pac. 363, Ann. Cas. 1915 A 816, 821n; *Enterprise Ditch Co. v. Moffitt*, 58 Neb. 642, 79 N. W. 560, 45 L. R. A. 647, 76 Am. St. Rep. 122n; *Wall v. Basin Min. Co.*, 16 Idaho 313, 101 Pac. 733, 22 L. R. A. (N. S.) 1013; *Fletcher, Corporations*, sec. 4279.

¹⁵ *Martin v. Palmer Union Oil Co.*, 184 Cal. 386, 193 Pac. 950.

¹⁶ *Budd v. Multnomah St. Ry. Co.*, 15 Ore. 413, 15 Pac. 659, 3 Am. St. Rep. 169; *Westcott v. Minnesota Min. Co.*, 23 Mich. 145; *In re St. Lawrence Steamboat Co.*, 44 N. J. Law 529; *Vasey v. New Export Coal Co.*, 89 W. Va. 491, 109 S. E. 619. See *American Well & Prospecting Co. v. Blake-more*, 184 Cal. 343, 193 Pac. 779, 19 A. L. R. 1087, 1096.

the choice to pursue either remedy. In some states assessments are enforceable only by a sale of the stock unless the articles otherwise provide.¹⁷ A stockholder is entitled to reasonable notice before a sale or forfeiture of his shares for nonpayment of assessments, whether it is expressly required by the charter, statute, or by-laws, or not.¹⁸ Where the stockholder's shares have been forfeited for the nonpayment of assessments by the corporation while insolvent, the forfeiture of the stock will relieve the shareholders of liability to creditors for the balance of their unpaid subscriptions.¹⁹ But this is the case only where the forfeiture is made in good faith. The power to forfeit cannot be exercised for the purpose of discharging stock subscribers from liability to creditors.²⁰

B. LIABILITIES OF STOCKHOLDERS TO CREDITORS.

I. LIABILITY ON ACCOUNT OF UNPAID SUBSCRIPTIONS.

§ 199. **Basis and extent of liability.**—Any balance that may be due from the stockholders of a corporation on their stock constitutes a part of the assets of the corporation, and, on the dissolution or insolvency of the corporation, its creditors, having exhausted their legal remedies against the corporation, may sue in equity to compel the stockholders to pay in the same, and have it applied to the satisfaction of their claims so far as needed.

The capital stock of a corporation—that is, the amount subscribed and paid in or agreed to be paid in by the stockholders, either in money, or in property, labor, or services—is the basis of its credit, since the stockholders are not personally liable for its debts unless such liability is imposed by statute. Persons deal with a corporation on the faith of this fund, and, if it is not paid in, they have a right to insist that it shall be paid in, when its payment is necessary for the satisfaction of their claims against the corporation. It is perfectly well settled, therefore, that when stockholders are indebted to a corporation on account of their stock,

¹⁷ *Weede v. Emma Copper Co.*, 58 Utah 524, 200 Pac. 517. See *Quintet Oil Co. v. Big Five Oil Co.*, 71 Colo. 232, 205 Pac. 949 (agreement).

¹⁸ *American Well & Prospecting Co. v. Blakemore*, 184 Cal. 343, 193 Pac. 779, 19 A. L. R. 1087; *Germantown Passenger Ry. Co. v. Fittler*, 60 Pa. St. 124, 100 Am. Dec. 546;

Rutland & B. R. Co. v. Thrall, 35 Vt. 536.

¹⁹ *American Well & Prospecting Co. v. Blakemore*, 184 Cal. 343, 193 Pac. 779, 19 A. L. R. 1087.

²⁰ See 5 Minnesota Law Rev. 313; 2 Morawetz, *Corporations* (2nd Ed.), sec. 857; 7 Thompson, *Corporations* (2nd Ed.), sec. 8680.

and the corporation becomes insolvent, they may be compelled to pay the amount due by a creditors' suit or other proper proceeding, in so far as such payment may be necessary to satisfy the claims of creditors.²¹

This liability of stockholders is often based by the courts upon the ground that the capital stock of a corporation is a trust fund for the benefit of creditors.²² But it is not at all necessary to base the liability on this ground. Unpaid subscriptions, when there is a liability as between the stockholders and the corporation, are like any other assets of the corporation when it becomes insolvent, and may be collected, through the interposition of a court of equity, for the purpose of paying its debts; and if the corporation has secretly agreed not to require payment, or if it has released the subscribers without consideration, the agreement or release may be held void as against creditors on the ground of fraud.²³

Extent of liability, and contribution among stockholders.—Stockholders are liable for a balance due on their stock in a suit by or for the benefit of creditors of the corporation to such extent only as payment may be necessary for satisfaction of the debts of the corporation;^{23a} but they are liable for the full amount due if necessary for this purpose. The liability of the stockholders is several and not joint. Each is liable for the full amount due on his stock, irrespective of the liability of others, so far as creditors are concerned, although he may be entitled to contribution from the other stockholders if he is compelled to pay more than his proportion as between the stockholders.^{23b} It has been held, therefore,

²¹ *Ogilvie v. Knox Ins. Co.*, 22 How. (U. S.) 380, 16 L. Ed. 349; *Sawyer v. Hoag*, 17 Wall. 610, 21 L. Ed. 731; *Upton v. Tribilcock*, 91 U. S. 45, 23 L. Ed. 203; *Hatch v. Dana*, 101 U. S. 205, 25 L. Ed. 885; *Glenn v. Semple*, 80 Ala. 159, 60 Am. Rep. 92; *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158; *Geary St. P. & O. R. Co. v. Rolph*, 189 Cal. 59, 207 Pac. 539; *Crandall v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560; *Hightower v. Thornton*, 8 Ga. 486, 52 Am. Dec. 412; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133; *Burt v. Real Estate Exchange*, 175 Pa. St. 619, 34 Atl. 923, 52 Am. St. Rep. 858; *Cole-*

man v. White, 14 Wis. 700, 80 Am. Dec. 797; *Adler v. Milwaukee Patent Brick Mfg. Co.*, 13 Wis. 57.

²² *Sanger v. Upton*, 91 U. S. 56, 23 L. Ed. 220; *Perkins v. Cowles*, 157 Cal. 625, 108 Pac. 711, 30 L. R. A. (N. S.) 283, 137 Am. St. Rep. 158; *Holcombe v. Trenton White City Co.*, 80 N. J. Eq. 122, 82 Atl. 618.

²³ *Vermont Marble Co. v. Declez Granite Co.*, 135 Cal. 579, 67 Pac. 1057, 56 L. R. A. 728, 87 Am. St. Rep. 143; *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 L. Ed. 731.

^{23a} *Seovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968.

^{23b} *Haslett's Ex'rs v. Wotherspoon*, 1 Strob. Eq. (S. C.) 209; *Ogilvie v. Knox Ins. Co.*, 22 How. (U. S.) 380, 16 L. Ed. 349; *Hatch v. Dana*, 101 U.

that each stockholder is liable for the full amount due on his stock, if its collection is necessary for the payment of debts of the corporation, notwithstanding the fact that some of the stockholders are insolvent, and nothing at all can be collected from them;²³⁰ and that creditors may sue in equity to reach the amount due from particular stockholders, without proceeding against other stockholders who are also liable, or making them parties.²³¹

Contribution.—When several stockholders are indebted to a corporation on account of unpaid subscriptions, and one of them is compelled to pay more than his proportion to or for the benefit of creditors, he is entitled to contribution from the others; and this is true, whether the latter are residents or nonresidents of the state.²³² The remedy to enforce contribution as between stockholders is in equity, in the absence of any statute prescribing a special remedy. A stockholder who is made a defendant to a creditors' bill to reach his unpaid subscription may file a cross bill, and bring in any stockholders who are not parties thereto, and enforce contribution from them in that suit.²³³ Or, after having been compelled to pay more than his proportion, he may maintain an independent suit against the other stockholders for contribution.²³⁴

§ 200. Remedies of creditors against stockholders upon unpaid subscriptions.

Since a subscription for stock in a corporation is a contract between the subscriber and the corporation, and there is no direct

S. 205, 25 L. Ed. 885; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133; *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158; *Thompson v. Reno Sav. Bank*, 19 Nev. 242, 9 Pac. 121, 3 Am. St. Rep. 883; *Blood v. La Serena Land & Water Co.*, 150 Cal. 764, 89 Pac. 1090; *Olsen Mfg. Co. v. Rex Motor Co.*, 203 Mich. 470, 170 N. W. 64.

²³⁰ *Haslett's Ex'rs v. Wotherspoon*, 1 Strob. Eq. (S. C.) 209; *Holcombe v. Trenton White City Co.*, 80 N. J. Eq. 122, 82 Atl. 618; *John W. Cooney Co. v. Arlington Hotel Co.*, 11 Del. Ch. 286, 101 Atl. 879.

²³¹ See the cases in notes 35, 38, post, § 200.

²³² *Geary St., P. & O. R. Co. v.*

Rolph, 189 Cal. 59, 207 Pac. 539; *Allen v. Fairbanks*, 40 Fed. 188; s. c., 45 Fed. 445; *Bennison v. McConnell*, 56 Neb. 46, 76 N. W. 412; *Wincock v. Turpin*, 96 Ill. 135; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Young v. Farwell*, 139 Ill. 326, 28 N. E. 845; *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133.

²³³ *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Young v. Farwell*, 139 Ill. 326, 23 N. E. 845.

²³⁴ *Singer v. Hutchinson*, 183 Ill. 606, 620, 56 N. E. 388, 75 Am. St. Rep. 133, 140. See *Fier v. Emmert*, 36 Md. 464; *Bennison v. McConnell*, 56 Neb. 46, 76 N. W. 412; *Putnam v. Misochi*, 189 Mass. 421, 75 N. E. 956, 109 Am. St. Rep. 648, 4 Ann. Cas. 733.

contract relation whatever between the subscriber and creditors of the corporation, creditors, even though the corporation may be insolvent or may have been dissolved, cannot maintain an action at law against subscribers, in the absence of a statute, to recover against them to the extent of the balance due on their subscriptions.²⁴

The proper and usual remedy of creditors to enforce payment of subscriptions is by creditors' bill in equity. A creditor of the corporation, after having exhausted his legal remedies against it by recovering a judgment and issuing an execution, or, under some circumstances, without this, may maintain a bill in equity, on behalf of himself and other creditors who may come into the suit, or, in some jurisdictions, on his own behalf only, to compel the stockholders, or some of them, to pay in the amount due on their stock, and have the same applied in satisfaction of his claim, or of the claims of himself and other creditors, according to the rule in the particular jurisdiction. The jurisdiction of a court of equity in such a case to reach and subject the subscription liability of the stockholder of the corporation to the payment of its debts is too clear and too well settled to admit of controversy.²⁵ The obligation of the subscriber to pay up the par value of his stock is an asset of the corporation which may be reached by a creditor's bill, a kind of equitable execution. The fact that the contracts of subscription provide for payment upon call of the directors, and that no call has been made, will not defeat a creditors' suit to compel payment of the subscriptions, for the court has jurisdiction to compel the directors to make calls, or to make the calls itself.²⁶ When one subscribes or becomes the transferee of partially-paid stock, which does not purport to be fully paid, he assumes as an

²⁴ *Brown v. Fisk*, 23 Fed. 228; *Patterson v. Lynde*, 106 U. S. 519, 27 L. Ed. 265, 1 Sup. Ct. 432; *Jones v. Jarman*, 34 Ark. 323; *Thompson-Houston Elec. Co. v. Murray*, 60 N. J. Law 20, 37 Atl. 443.

²⁵ *Ogilvie v. Knox Ins. Co.*, 22 How. (U. S.) 380, 16 L. Ed. 349; *Hatch v. Dana*, 101 U. S. 205, 25 L. Ed. 885; *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158; *Fish v. Smith*, 73 Conn. 377, 47 Atl. 711, 84 Am. St. Rep. 161; *Hightower v. Thornton*, 8 Ga. 486, 52 Am. Dec. 412; *Harrell v. Blount*, 112 Ga. 711, 38 S. E. 56; *Coleman v. Howe*, 154 Ill. 458, 39 N.

E. 725, 45 Am. St. Rep. 133; *Adler v. Milwaukee Patent Brick Mfg. Co.*, 13 Wis. 57; *Dill v. Ebey*, 27 Okla. 584, 112 Pac. 973, 46 L. R. A. (N. S.) 440, 448n; *Thompson, Corporations* (2nd Ed.) 4942, 4952, 5075.

²⁶ *Hatch v. Dana*, 101 U. S. 205, 25 L. Ed. 885; *Seovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *O'Brien v. Lashar*, 274 Fed. 326; *Curry v. Woodward*, 53 Ala. 371; *Glenn v. Semple*, 80 Ala. 159, 60 Am. Rep. 92; *Geary St., P. & O. R. Co. v. Rolph*, 189 Cal. 59, 207 Pac. 539; *Kaye v. Metz*, 186 Cal. 42, 198 Pac. 1047; *Dalton & M. R. Co. v. McDaniel*, 56 Ga. 191.

incident of the relationship of stockholder the obligation to respond to calls upon him for further contributions to the capital of the company until the par value of his stock is fully paid in.²⁷

Exhausting legal remedies against the corporation.—Judgment and execution.—It is a general principle in relation to creditors' suits, applicable, of course, to suits by creditors of corporations, that a creditor cannot maintain a bill in equity to reach equitable assets of his debtor, and subject them to the payment of his claim, until he has first exhausted his legal remedy;²⁸ and as a general rule, therefore, a creditor of a corporation cannot sue in equity to reach and subject to the payment of his claim unpaid stock subscriptions until he has recovered a judgment against the corporation, and an execution thereon has been returned wholly or partly unsatisfied, unless he shows a good excuse.²⁹ This rule does not apply, however, when the corporation has been dissolved, or when, for any other reason, it is not possible to obtain a judgment against it.³⁰ And the issue and return of an execution is not necessary where it appears that, by reason of the bankruptcy or notorious insolvency of the corporation, such a step would have been an idle and useless ceremony.³¹ The return of execution unsatisfied is conclusive evidence that the creditor has exhausted his legal remedy, and stockholders cannot avoid its effect by showing that the corporation was in fact the owner and in possession of a large amount of personal property which might have been levied upon.³² By express statutory provision in some states, a creditor may maintain a creditors' bill against an insolvent corporation to reach equitable assets, including unpaid subscriptions, without first obtaining a judgment against the corporation.³³

²⁷ Rhode v. Dock-Hop Co., 184 Cal. 367, 194 Pac. 11, 12 A. L. R. 437; Perkins v. Cowles, 157 Cal. 625, 108 Pac. 711, 30 L. R. A. (N. S.) 283, 137 Am. St. Rep. 158.

²⁸ Baines v. Babcock, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158.

²⁹ Ogilvie v. Knox Ins. Co., 22 How. (U. S.) 380, 16 L. Ed. 349; Hollins v. Brierfield Coal & Iron Co., 150 U. S. 371, 37 L. Ed. 1113, 14 Sup. Ct. 127; National Tube-Works Co. v. Ballou, 146 U. S. 517, 36 L. Ed. 1070, 13 Sup. Ct. 165; Payne v. Bulard, 23 Miss. 88, 55 Am. Dec. 74; Patterson v. Lynde, 112 Ill. 196; Llewellyn Iron Works v. Abbott Kin-

ney Co., 172 Cal. 210, 155 Pac. 986; Cordes v. Hammond, 55 Cal. App. 55, 203 Pac. 131.

³⁰ John A. Roebling's Sons Co. v. Federal Storage Battery Car Co., 185 N. Y. App. Div. 430, 173 N. Y. Supp. 297.

³¹ Terry v. Anderson, 95 U. S. 628, 636, 24 L. Ed. 365; Salt Lake Hardware Co. v. Tintie Milling Co., 13 Utah 423, 45 Pac. 200.

³² Baines v. Babcock, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158.

³³ Cohn v. Waters, 83 Ill. App. 387; Jagers v. Howell, 206 Ala. 337, 89 So. 604.

Parties to creditors' suit.—Most of the courts hold that a creditors' bill to reach unpaid subscriptions to the capital stock of a corporation, when it is insolvent, while it need not make all the creditors actual parties, must be brought on behalf of all who may come in, on the ground that, when a corporation becomes insolvent, and such proceedings are taken, a court of equity looks upon its assets, including unpaid subscriptions, as a trust fund for the benefit of all its creditors, and that no one creditor can go into equity and appropriate such assets exclusively to himself.³⁴

According to the weight of authority, a creditors' bill to reach unpaid subscriptions may be maintained against the corporation and one or more stockholders, without making all the stockholders parties. The fact that the other stockholders are also liable is immaterial. If one of them is thus compelled to pay more than his share, he may sue the others for contribution, or have them made parties to the suit, in a proper case, so that all rights may be adjusted, but with this matter the creditors are not concerned.³⁵ This is true also of a suit to compel payment of the balance due on watered or fictitiously paid-up stock.³⁶ "A judgment creditor, who has exhausted his legal remedy," said Mr. Justice Bradley in a federal case, "may pursue, in a court of equity, any equitable

³⁴ *Patterson v. Lynde*, 106 U. S. 519, 27 L. Ed. 265, 1 Sup. Ct. 432; *Thompson v. Reno Sav. Bank*, 19 Nev. 103, 7 Pac. 68, 3 Am. St. Rep. 797; *Bickley v. Schlag*, 46 N. J. Eq. 533, 20 Atl. 250; *Adler v. Milwaukee Patent Brick Mfg. Co.*, 13 Wis. 57; *Coleman v. White*, 14 Wis. 700, 80 Am. Dec. 797; *In re Bunn's Appeal*, 105 Pa. St. 49, 51 Am. Rep. 166. See *Randall Printing Co. v. Sanitas Mineral Water Co.*, 120 Minn. 268, 139 N. W. 606, 43 L. R. A. (N. S.) 706; *Hanson v. Davison*, 73 Minn. 454, 76 N. W. 254; *Goldman v. Christy*, 155 Minn. 91, 192 N. W. 360; *John A. Roebling's Sons Co. v. Kinnicutt*, 248 Fed. 596. Compare, *Harrell v. Blount*, 112 Ga. 711, 38 S. E. 56.

The liability of stockholders for unpaid subscriptions involves a fund for the benefit of all creditors in proportionate shares. *Signor Tie Co. v. Monett & S. W. Const. Co.*, 198 Fed. 412. The bill must be filed either by all the creditors or in behalf of all who desire to make themselves parties. *Second Nat. Bank v. Georger*, 246 Fed. 517.

³⁵ *Ogilvie v. Knox Ins. Co.*, 22 How. (U. S.) 380, 16 L. Ed. 349; *Hatch v. Dana*, 101 U. S. 205, 25 L. Ed. 885; *Geary St., P. & O. R. Co. v. Rolph*, 189 Cal. 59, 207 Pac. 539; *Pierce v. Milwaukee Const. Co.*, 38 Wis. 253; *Thompson v. Reno Sav. Bank*, 19 Nev. 103, 7 Pac. 68, 3 Am. St. Rep. 797; *s. c.*, 19 Nev. 242, 9 Pac. 121, 3 Am. St. Rep. 883; *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133; *Brundage v. Monumental Gold & Silver Min. Co.*, 12 Ore. 322, 7 Pac. 314; *Martin v. South Salem Land Co.*, 94 Va. 28, 26 S. E. 591; *Cooper v. Adel Security Co.*, 127 N. C. 219, 37 S. E. 216.

³⁶ *Rhode v. Dock-Hop Co.*, 184 Cal. 367, 194 Pac. 11, 12 A. L. R. 437; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133.

interest, trust or demand of his debtor, in whosoever hands it may be. And if the party thus reached has a remedy over against other parties for contribution or indemnity, it will be no defense to the primary suit against him that they are not parties. If a creditor were to be stayed until all such parties could be made to contribute their proportionate shares of the liability, he might never get his money."³⁷ This doctrine, however, is not recognized in all jurisdictions. In some states it is held that when a corporation becomes insolvent, and it is necessary to resort to unpaid stock subscriptions for the payment of its debts, only so much of the unpaid capital can be called in as is necessary for the payment of debts, after exhausting all the other assets, and that it is necessary in such a case that an account shall be taken of the amount of debts, assets, and unpaid capital, and a decree made for an assessment of the amount due by each stockholder; and where this doctrine is held, it is necessary that all the stockholders shall be made parties to a creditors' suit to reach unpaid stock subscriptions, unless sufficient excuse is shown for not making them all parties.³⁸ It is not necessary to join stockholders who are beyond the jurisdiction of the court, or who are insolvent.³⁹

As against an objection seasonably and properly made, the corporation itself is a necessary party to a creditors' suit to reach unpaid subscriptions,⁴⁰ unless it is beyond the jurisdiction of the court, or has been dissolved,⁴¹ but it is not an indispensable party. Objection to its nonjoinder is waived if it is not made by demurrer or answer.⁴²

³⁷ *Marsh v. Burroughs*, 1 Woods 468, Fed. Cas. No. 9112. And see *Ogilvie v. Knox Ins. Co.*, 22 How. (U. S.) 380, 16 L. Ed. 349.

If the object of a suit is to wind up the affairs of the corporation, all the stockholders, so far as they can be ascertained, should be made parties, so that complete justice may be done by equalizing the burdens, and in order to prevent a multiplicity of suits. *Hatch v. Dana*, 101 U. S. 205, 25 L. Ed. 885.

³⁸ *In re Bell's Appeal*, 115 Pa. St. 88, 8 Atl. 177, 2 Am. St. Rep. 532; *In re Bunn's Appeal*, 105 Pa. St. 49, 51 Am. Rep. 166; *Cook v. Carpenter*, 212 Pa. 165, 61 Atl. 799, 1 L. R. A. (N. S.) 900, 4 Ann. Cas. 723, 108 Am. St. Rep. 854; *M. A. Gedney Co. v. Sanford*, 105 Neb. 112, 179 N. W. 885. See post, § 224.

³⁹ *Wilson v. California Wine Co.*, 95 Mich. 117, 54 N. W. 643; *Second Nat. Bank v. Georger*, 246 Fed. 517.

⁴⁰ *Walsh v. Memphis, Carthage & N. W. R. Co.*, 2 McCrary 156, 6 Fed. 797; *Clinton Min. Co. v. Cochran*, 247 Fed. 449; *Adler v. Milwaukee Patent Brick Mfg. Co.*, 13 Wis. 57; *Coleman v. White*, 14 Wis. 700, 80 Am. Dec. 797; *King v. Sullivan*, 93 Ga. 621, 20 S. E. 76; *Mann v. Pentz*, 3 N. Y. 415; *Perkins v. Sanders*, 56 Miss. 733; *Wetherbee v. Baker*, 35 N. J. Eq. 501.

⁴¹ *Walser v. Seligman*, 21 Blatchf. 130, 13 Fed. 415.

⁴² *Potter v. Dear*, 95 Cal. 578, 30 Pac. 777. And see *Wetherbee v. Baker*, 35 N. J. Eq. 501; *Blood v. La Serena Land & Water Co.*, 150 Cal. 764, 89 Pac. 1090.

§ 201. Enforcement of liability by receivers and trustees in bankruptcy.

When authorized by the court, the receiver, in most jurisdictions by express statutory provision, and in others without any statutory provision, may maintain actions at law, or, in a proper case, a suit in equity, in his own name, against the stockholders to recover what may be due.⁴³ It has been held that, when a call has been made by the corporation or by the court, or when no call is necessary, the remedy of the receiver is by an action at law, and that he cannot sue in equity,⁴⁴ but this can only be true when no special grounds of equitable jurisdiction exist.⁴⁵ A receiver appointed by a competent court in the state of the corporation's domicile may, by comity, maintain actions against nonresident stockholders in other states.⁴⁶

Bankruptcy or insolvency proceedings.—Unpaid subscriptions for stock in a corporation will pass under the Federal Bankruptcy Law to the trustee in bankruptcy of the corporation. The court has jurisdiction to make an assessment or call which will be binding upon all the stockholders, and the trustee may enforce the same by actions at law in his own name against the stockholders.⁴⁷

⁴³ *Hollander v. Heaslip*, 222 Fed. 808; *Rosoff v. Gilbert Transp. Co.*, 221 Fed. 972; *Hodde v. Hahn*, 283 Mo. 320, 222 S. W. 799.

⁴⁴ *Barkalow v. Totten*, 53 N. J. Eq. 573, 32 Atl. 2; *Smith v. Johnson*, 57 Ohio St. 486, 57 N. E. 693; *Burke v. Scheer*, 89 Neb. 80, 130 N. W. 962, 33 L. R. A. (N. S.) 1057; *Clinton Mining & Mineral Co. v. Cochran*, 247 Fed. 449; *Britton v. Andrews*, 8 Fed. (2d) 950, 954. But see *Chamberlain v. Piercy*, 82 Wash. 157, 143 Pac. 977; *Fletcher, Corporations*, sec. 4122, p. 7105.

⁴⁵ See *Bausman v. Denny*, 73 Fed. 69; *Peck v. Elliott*, 79 Fed. 10, 38 L. R. A. 616; *Naumberg v. See*, 56 N. J. Eq. 453, 41 Atl. 1116, aff'g 55 N. J. Eq. 240, 36 Atl. 966; *McDermott v. Woodhouse*, 87 N. J. Eq. 615, 101 Atl. 375; *Cook v. Carpenter*, 212 Pa. 165, 61 Atl. 799, 1 L. R. A. (N. S.) 900, 108 Am. St. Rep. 854, Ann. Cas. 723.

In *Calkins v. Atkinson*, 2 Lans. (N. Y.) 12, it was held that a receiver of an insolvent corporation may sue in equity, making the stockholders and

creditors parties, to obtain an accounting of the debts due the creditors, to ascertain and enforce the liability of the stockholders, and to restrain creditors from prosecuting independent suits against the stockholders.

⁴⁶ *Stoddard v. Lum*, 159 N. Y. 265, 53 N. E. 1108, 45 L. R. A. 551, 70 Am. St. Rep. 541; *Castleman v. Templeman*, 87 Md. 546, 40 Atl. 275, 41 L. R. A. 367, 67 Am. St. Rep. 363; *Hawkins v. Glenn*, 131 U. S. 319, 33 L. Ed. 184, 9 Sup. Ct. 739; *Semple v. Glenn*, 91 Ala. 245, 6 So. 46, 9 So. 265, 24 Am. St. Rep. 894; *Parker v. Stoughton Mill Co.*, 91 Wis. 174, 64 N. W. 751, 51 Am. St. Rep. 881.

⁴⁷ *Sanger v. Upton*, 91 U. S. 56, 23 L. Ed. 220; *Webster v. Upton*, 91 U. S. 65, 23 L. Ed. 384; *Seovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968. See *Kelley v. Gill*, 245 U. S. 116, 62 L. Ed. 185, 38 Sup. Ct. 38. The elements essential to jurisdiction in equity to avoid multiplicity of actions at law are lacking as there is no common issue between the alleged stockholders and the corporation. The

There is a conflict of authority, however, whether the trustee in bankruptcy may collect for the underpayment from the holders of watered or fictitiously paid-up stock, depending upon whether such claim is regarded as a corporate asset or as belonging to the creditors only.⁴⁸

§ 202. Conclusiveness of judgment against the corporation as against stockholders.

It is well settled that a corporation represents its stockholders in all matters within the scope of its corporate powers transacted in good faith by its officers. In an action against a corporation by a creditor, the stockholders are represented by the corporation, within this principle; and it follows that the judgment rendered against the corporation therein, if the court has jurisdiction, is conclusive upon the stockholders, in the absence of fraud or collusion, in any collateral suits or proceedings against them, in equity or at law, to compel payment of the balance due on their stock. They cannot attack the judgment, for example, in the absence of fraud or collusion, on the ground that the corporation was not indebted to the creditor in whose favor it has been rendered,⁴⁹ or on the ground that the alleged indebtedness arose out of an *ultra vires* transaction, etc.⁵⁰ This principle applies to stockholders

remedy is by separate action at law against each. See *Schroeter v. Abbott*, 185 Cal. 146, 196 Pac. 39.

"The overwhelming weight of authority is that, after the appointment of a general receiver for the purpose of winding up the affairs of a corporation, or after the appointment of a trustee in bankruptcy, such officer has the sole and exclusive right to maintain suits for the collection of unpaid stock subscriptions. 14a Corp. Jur. 987, 994; *Cook on Corporations*, sec. 208; *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 621, 21 L. Ed. 731; *Scovill v. Thayer*, 105 U. S. 143, 155, 156, 26 L. Ed. 968. See *Porter v. Sabin*, 149 U. S. 473, 37 L. Ed. 815, 13 Sup. Ct. 1008; *Klein v. Peter*, 284 Fed. 797, 29 A. L. R. 1497." *Reagan v. Midland Packing Co.*, 8 Fed. (2d) 954.

⁴⁸ That it is not a corporate asset, see *Courtney v. Georger*, 228 Fed. 859; *Courtney v. Croxton*, 239 Fed. 247; *State Bank of Commerce v. Kenney Band Instrument Co.*, 143 Minn. 236, 173 N. W. 560; *In re Associated Oil Co.*, 289 Fed. 693.

Compare cases that it is a corporate asset, *Du Pont v. Ball*, 11 Del. Ch. 430, 106 Atl. 39, 7 A. L. R. 955; *In re Pipe Line Oil Co.*, 289 Fed. 698; *Babbitt v. Read*, 215 Fed. 395, aff'd 236 Fed. 42; 29 *Harvard Law Rev.* 854; *Fletcher, Corporations*, sec. 4215.

⁴⁹ *Coe v. Armour Fertilizer Works*, 237 U. S. 413, 59 L. Ed. 1027, 35 Sup. Ct. 625; *Hendrickson v. Bradley*, 85 Fed. 508; *Lehman, Durr & Co. v. Glenn*, 87 Ala. 618, 6 So. 44; *Tatum v. Rosenthal*, 95 Cal. 129, 30 Pac. 136, 29 Am. St. Rep. 127; *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 29 Am. St. Rep. 158; *Glenn v. Williams*, 60 Md. 93; *Nichols v. Stevens*, 123 Mo. 96, 25 S. W. 578, 45 Am. St. Rep. 514. See 27 *Columbia Law Rev.* 97.

⁵⁰ *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158; *Keyes v. Baskerville*, 41 S. D. 214, 170 N. W. 143; s. c., 42 S. D. 381, 175 N. W. 874. But see as to statutory liability, *State ex rel. Hilton v. Mortgage Security Co.*, 154

who are residents of other states.⁵¹ The judgment may be attacked by stockholders for want of jurisdiction, or for fraud or collusion between the officers of the corporation and the creditor.⁵² The stockholder is, however, entitled to his day in court and a hearing upon whether he is a stockholder and indebted, and other defenses personal to himself.

§ 203. Defenses available to stockholders.

Creditors can compel an alleged stockholder to pay on the ground of an unpaid balance due on the subscription price or par value of stock only when payment might be enforced in an action by the corporation itself. When a person, therefore, is sued by or for the benefit of creditors upon an alleged subscription for stock, he may set up any defense such as fraud in procuring the subscription, which he could have successfully set up in an action by the corporation, unless he is for some reason estopped as against creditors, as will be explained in a subsequent section.⁵³ According to the better opinion a subscription for stock may be rescinded after the insolvency of the corporation, where the fraud was not discovered before insolvency, and the subscriber has not been guilty of laches.⁵⁴ But the defrauded stockholder must exercise a high degree of diligence in discovering the fraud and rescinding the subscription so that creditors may not be misled or prejudiced, and must manifest his election to the corporation before the rights of creditors and other stockholders intervene.⁵⁵ After a corporation has contracted

Minn. 453, 192 N. W. 348, noted in 7 Minnesota Law Rev. 500.

⁵¹ Hawkins v. Glenn, 131 U. S. 319, 33 L. Ed. 184, 9 Sup. Ct. 739; Glenn v. Liggett, 135 U. S. 533, 34 L. Ed. 262, 10 Sup. Ct. 867; Mutual Fire Ins. Co. v. Phoenix Furniture Co., 108 Mich. 170, 66 N. W. 1095, 34 L. R. A. 694, 62 Am. St. Rep. 693; Semple v. Glenn, 91 Ala. 245, 6 So. 46, 9 So. 265, 24 Am. St. Rep. 894.

⁵² Coe v. Armour Fertilizer Works, 237 U. S. 413, 59 L. Ed. 1027, 35 Sup. Ct. 625; Bissitt v. Kentucky River Navigation Co., 15 Fed. 353; Wilson v. Kiesel, 9 Utah 397, 35 Pac. 488.

⁵³ San Bernardino County Sav. Bank v. Denman, 186 Cal. 710, 200 Pac. 606; Grier v. Union Nat. Life Ins. Co., 217 Fed. 287; Glenn v. Garth, 133 N. Y. 18, 30 N. E. 649, 31 N. E. 344. See post, § 204.

⁵⁴ Gress v. Knight, 135 Ga. 60, 68 S. E. 834, 31 L. R. A. (N. S.) 900; Newton Nat. Bank v. Newbegin, 74 Fed. 135, 33 L. R. A. 727; Savage v. Bartlett, 78 Md. 561, 28 Atl. 414; Fear v. Bartlett, 81 Md. 435, 32 Atl. 322, 33 L. R. A. 721. The contrary, however, is held in some jurisdictions. Oakes v. Turquand, L. R. 2 H. L. 325; Henderson v. Royal British Bank, 7 Ed. & Bl. 356; Martin v. South Salem Land Co., 94 Va. 28, 26 S. E. 591; Bank of North America v. Pennsylvania Oil Refining Co., 216 Fed. 377; Howard v. Turner, 155 Pa. St. 349, 26 Atl. 753, 35 Am. St. Rep. 883; Duffield v. Barnum Wire & Iron Works, 64 Mich. 293, 31 N. W. 310.

⁵⁵ In all jurisdictions, insolvency of the corporation will bar rescission of a subscription on the ground of fraud, where there has been laches, either in electing to rescind after discovery

debts and become insolvent, persons who have held shares of stock therein, particularly when they have acted as stockholders or officers, cannot escape liability to or for the benefit of creditors by setting up the defense that they never subscribed for the stock at all, or, if they did, that their subscriptions were induced by fraud or otherwise invalid.⁵⁶

If the subscriber has been discharged from liability on his subscription by a valid release by the corporation, he may defeat an action for the benefit of creditors.⁵⁷ But a release by the corporation may be valid as against the corporation, but fraudulent and void as against creditors, as in the case of watered and fictitiously paid-up stock.⁵⁸

§ 204. Set-off of debts due to stockholders.

When a stockholder is indebted to a corporation for a balance on his stock, and also has a valid claim against the corporation, he may set off his claim against his liability, provided the corporation is not insolvent, and payment for the stock is not necessary to satisfy the claim of other creditors. But it is well settled in most jurisdictions that when a corporation is known to be insolvent, stock-

of the fraud or in discovering the fraud. *Chubb v. Upton*, 95 U. S. 665, 24 L. Ed. 523; *Hilliard v. Allegheny Geometrical Wood Carving Co.*, 173 Pa. St. 1, 34 Atl. 236; *Howard v. Turner*, 155 Pa. St. 349, 26 Atl. 753, 35 Am. St. Rep. 883; *Martin v. South Salem Land Co.*, 94 Va. 28, 26 S. E. 591; *Duffield v. Barnum Wire & Iron Works*, 64 Mich. 293, 31 N. W. 310; *Olson v. State Bank*, 67 Minn. 267, 69 N. W. 904. See *Reid v. Owensboro Sav. Bank & Trust Co.*, 141 Ky. 444, 132 S. W. 1026; *Stone v. Walker*, 201 Ala. 130, 77 So. 554, L. R. A. 1918 C 839; 5 Minnesota Law Rev. 219. See also, ante, § 44.

⁵⁶ *Upton v. Tribilcock*, 91 U. S. 45, 23 L. Ed. 203; *Shickle v. Watts*, 94 Mo. 410, 7 S. W. 274; *Griswold v. Seligman*, 72 Mo. 110; *Lane v. Brainerd*, 30 Conn. 565; *Canfield v. Gregory*, 66 Conn. 9, 33 Atl. 536; *Thompson v. Reno Sav. Bank*, 19 Nev. 103, 7 Pac. 68, 3 Am. St. Rep. 797; *Musgrave v. Morrison*, 54 Md. 161; *Hickling v. Wilson*, 104 Ill. 54; *Clarke v. Thomas*, 34 Ohio St. 46; *Blien v. Rand*, 77 Minn. 110, 79 N. W. 606, 46 L. R. A. 618; *Calumet Paper Co. v.*

Stotts Investment Co., 96 Iowa 147, 64 N. W. 782, 59 Am. St. Rep. 362. See ante, § 44.

⁵⁷ *Trevor v. Whitworth*, 12 App. Cas. 409; *New Haven Trust Co. v. Gaffney*, 73 Conn. 480, 47 Atl. 760; *Shoemaker v. Washburn Lumber Co.*, 97 Wis. 585, 73 N. W. 333. See ante, § 42.

⁵⁸ A corporation cannot, except in pursuance of a *bona fide* compromise, release a stockholder from liability on his subscription, as against existing creditors, by accepting a surrender of his shares, or purchasing them, or otherwise. As against them, the release is fraudulent and void, and the stockholder remains liable. *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 L. Ed. 731; *Payne v. Bullard*, 23 Miss. 88, 55 Am. Dec. 74; *Harmon v. Hunt*, 116 N. C. 678, 21 S. E. 559; *Boney v. Williams*, 55 N. J. Eq. 691, 38 Atl. 189; *Nichols v. Stevens*, 123 Mo. 96, 25 S. W. 578, 27 S. W. 613, 45 Am. St. Rep. 514.

That a release is valid as against subsequent creditors, see *Shoemaker v. Washburn Lumber Co.*, 97 Wis. 585, 73 N. W. 333.

holders who are also creditors cannot set off the debts due them from the corporation against their liability for their stock, and thus obtain a preference over the other creditors; but they must pay the full amount due on their stock, and then come in and share *pro rata* with the other creditors.⁵⁹ This rule has been based on the ground that "the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund for the benefit of the general creditors of the corporation."⁶⁰ The rule may be sustained, however, without resorting to any such theory, on the ground that the amount due is the basis of credit, and it would operate as a fraud upon creditors to allow stockholders, instead of paying the capital stock into the treasury of the corporation, to wait until the corporation becomes insolvent, and then appropriate what they owe to their own claims against the corporation, to the exclusion of the other creditors.⁶¹

§ 205. Application of the statute of limitations.

Unpaid subscriptions create, as to the amount due thereon, the relation of debtor and creditor between the subscribers and the corporation, and if the statute of limitations runs against an action by the corporation to collect a subscription, as it may, it also runs, in the absence of fraud, against a suit in equity by creditors to compel payment, or an action by a receiver or assignee.⁶² The right of action of the creditor in equity does not arise until the recovery of judgment and the issuance of execution which is returned unsatisfied, when the creditor has exhausted his remedy at law. But in the creditor's bill to enforce unpaid subscriptions

⁵⁹ *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 L. Ed. 731; *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *Butterworth v. Smith*, 240 Mass. 192, 133 N. E. 100; *Kaye v. Metz*, 186 Cal. 42, 198 Pac. 1047; *Williams v. Traphagen*, 38 N. J. Eq. 57; *Thompson v. Reno Sav. Bank*, 19 Nev. 103, 7 Pac. 68, 3 Am. St. Rep. 797; *Singer v. Given*, 61 Iowa 93; *Bausman v. Kinnear*, 79 Fed. 172; *Efrd v. Piedmont Land Improvement & Investment Co.*, 55 S. C. 78, 32 S. E. 758, 897; *Richardson v. Merritt*, 74 Minn. 354, 77 N. W. 234, 407, 968. See *L. R. A.* 1918 E 243n.

⁶⁰ *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 L. Ed. 731; *Kiskadden v. Steinle*, 203 Fed. 375; *Bausman v.*

Kinnear, 79 Fed. 172. See 2 *Virginia Law Reg. (N. S.)* 151; 56 *Univ. Pennsylvania Law Rev.* 57.

⁶¹ See *Richardson v. Merritt*, 74 Minn. 354, 362, 77 N. W. 234, 407, 968.

⁶² *South Carolina Mfg. Co. v. Bank of South Carolina*, 6 Rich. Eq. (S. C.) 227; *Curry v. Woodward*, 53 Ala. 371; *Great Western Tel. Co. v. Gray*, 122 Ill. 630, 14 N. E. 214; *Williams v. Taylor*, 120 N. Y. 244, 24 N. E. 288; *Crofoot v. Thatcher*, 19 Utah 212, 57 Pac. 171, 75 Am. St. Rep. 725; *Thompson v. Reno Sav. Bank*, 19 Nev. 171, 7 Pac. 870, 3 Am. St. Rep. 881, and cases in the notes following.

the defense may be available to a stockholder that the statute has run as against the corporation upon his subscription. In case of bonus or watered stock, where the corporation has no right of action, the statute does not begin to run until return of execution or in some cases upon notorious insolvency of the corporation.⁶³

By the weight of authority, when subscriptions are payable upon call only, the statute of limitations does not begin to run, either as against the corporation or as against creditors, until a call is made, either by the directors or by a court of competent jurisdiction, although the corporation has ceased to do business, and has made an assignment of all its property, including unpaid subscriptions, for the benefit of creditors; and it does begin to run from the time of such a call.⁶⁴ When a subscription is payable upon call of the directors only, and they make no call before the corporation becomes insolvent and goes into the hands of a receiver, and the court then orders an assessment to be paid to the receiver, and, if not paid, to be collected by him, the statute of limitations runs from the date of such order only.⁶⁵

II. LIABILITY ON ACCOUNT OF WATERED OR FICTITIOUSLY PAID-UP STOCK.

§ 206. What is watered stock.—Watered stock is stock issued as fully paid-up when in fact the consideration accepted by the corporation was less than the par value of the stock or fictitious.

⁶³ *Spencer v. Anderson*, 193 Cal. 1, 222 Pac. 355, 35 A. L. R. 822, 850n.

The statute runs against the right of a creditor of a corporation to recover unpaid stock subscriptions only from the time of judgment and return of execution against the corporation unsatisfied; that is, from the time the creditor has exhausted his remedy against the corporation. Other courts hold that it runs from insolvency of the corporation or cessation of business. *Farmalee v. Price*, 208 Ill. 544, 70 N. E. 725.

⁶⁴ *Glenn v. Semple*, 80 Ala. 159, 60 Am. Rep. 92; *Semple v. Glenn*, 91 Ala. 245, 6 So. 46, 9 So. 265, 24 Am. St. Rep. 894; *Kaye v. Metz*, 186 Cal. 42, 193 Pac. 1047; *Glenn v. Williams*, 60 Md. 93; *Glenn v. Howard*, 81 Ga. 383, 8 S. E. 636, 12 Am. St. Rep. 318; *Washington Sav. Bank v. Butchers' & Drovers' Bank*, 107 Mo. 133, 17 S. W. 644, 28 Am. St. Rep. 405; *Van derwerken v. Glenn*, 85 Va. 9, 6 S. E.

806; *Hawkins v. Glenn*, 131 U. S. 319, 33 L. Ed. 184, 9 Sup. Ct. 739; *Glenn v. Marbury*, 145 U. S. 499, 36 L. Ed. 790, 12 Sup. Ct. 914. See 35 A. L. R. 834-839. But see *Shugart v. Maytag*, 188 Iowa 916, 176 N. W. 886.

In some cases it has been held that, in the case of insolvency or an assignment for the benefit of creditors, the statute runs from the time of the insolvency or assignment. *Glenn v. Dorsheimer*, 23 Fed. 695; *Swearingen v. Sewickley Dairy Co.*, 198 Pa. St. 68, 47 Atl. 941, 53 L. R. A. 471. See 35 A. L. R. 846n; *Harrigan v. Bergdall*, 270 U. S. 560, 70 L. Ed. 733, 46 Sup. Ct. 413.

⁶⁵ *Great Western Tel. Co. v. Gray*, 122 Ill. 630, 14 N. E. 214. See 35 A. L. R. 838n; *Thomas v. Kalbfus*, 97 Ohio St. 232, 119 N. E. 412.

If a receiver is required by statute to collect unpaid subscriptions at once, and no order of court is neces-

Payment for stock in property, labor, or services.—It is well settled, both in England and in this country, that a corporation need not necessarily receive money in payment for its stock, unless there is some requirement to this effect in its charter, or in the constitution or general laws of the state. Whether stock is issued upon subscription or sold, the corporation, in the absence of express restrictions, may receive payment therefor in property, labor, or services, provided the transaction is in good faith, and no fraud is perpetrated upon other stockholders or creditors.⁶⁶

When a corporation issues stock as full-paid, this is a representation, in the absence of anything to show the contrary, that it has received from the subscribers or purchasers the full par value of the shares, in money or its equivalent, as capital upon which to conduct its operations, and from which, if necessary, to pay its debts. In such a case, persons dealing with the corporation and becoming its creditors, and persons subscribing for or purchasing other shares, have a right to assume that the corporation has received or will receive the par value of the stock. If the shares have been issued by the corporation as full-paid, when in fact it has received or agreed to receive nothing at all for them, or less than their par value, either in money, or in property or services, the shares are said to be "watered," or "fictitiously paid up," to the extent to which they have not been or are not to be paid for. There are various ways in which watered stock may be issued. It may be issued gratuitously,—under an agreement that nothing at all shall be paid into the corporation therefor.⁶⁷ Or it may be issued upon payment of, or an agreement to pay, less than its par value in money, or for cash at a discount.⁶⁸ Or it may be issued in payment for property, labor, or services, the value of the property, labor, or services being known to be less than the par value

sary to entitle him to sue, the statute runs from the date of his appointment. *Webber v. Hovey*, 108 Mich. 49, 65 N. W. 619.

⁶⁶ *Spargo's Case*, 8 Ch. App. 407; *Coit v. North Carolina Gold Amalgamating Co.*, 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; *Sargent v. Palace Cafe Co.*, 175 Cal. 737, 167 Pac. 146; *Young v. Erie Iron Co.*, 65 Mich. 111, 31 N. W. 814; *Hastings Malting Co. v. Iron Range Brewing Co.*, 65 Minn. 28, 67 N. W. 652; *Liebke v. Knapp*, 79 Mo. 22, 49 Am. Rep.

212; *Van Cott v. Van Brunt*, 82 N. Y. 535; *Gamble v. Queen's County Water Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527; *McNeal Pipe & Foundry Co. v. Bullock*, 174 Pa. St. 93, 34 Atl. 594; *Fletcher, Corporations*, sec. 3503.

⁶⁷ *Scully v. Automobile Finance Co.*, 12 Del. Ch. 174, 109 Atl. 49.

⁶⁸ See *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429; *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968.

of the shares.⁶⁹ Or it may be issued in the guise of a stock dividend,—that is, issued to stockholders as stock representing surplus profits, or an increase in the value of property, when there are not sufficient profits or a sufficient increase in values to justify it.⁷⁰

§ 207. What amounts to overvaluation of consideration and underpayment of stock.—In most jurisdictions, when stock is issued for property, labor, or services, at an overvaluation known to be excessive, the transaction is fraudulent as against subsequent bona fide creditors, and they may compel payment of the difference between the par value of the stock and the actual value of the property, labor, or services. It is otherwise, however, if the valuation was made in good faith, and the overvaluation was due to mistake or mere error of judgment.

In some jurisdictions the “true value rule” as contrasted with the “good faith rule” is applied.

A subscriber for stock in a corporation to whom shares are originally issued is bound for the benefit of creditors, to pay for the stock its par value. This amount he may pay either in money or if the corporation agrees by the transfer of property or the rendering of personal services. The judgment of the directors of a corporation upon the value of property or services taken in payment of a stock subscription indebtedness is supposed to be an honest attempt to determine the value of the consideration so accepted by the corporation.

In some jurisdictions, there are statutory or constitutional provisions expressly requiring that property, labor, or services taken by a corporation in payment for stock shall be taken at a fair valuation; and even in the absence of an express provision, it operates as a fraud upon dissenting stockholders, and upon subsequent creditors relying upon the capital stock being fully paid, for the corporation to issue stock for property, labor, or services taken at an overvaluation. If a corporation, therefore, fraudulently issues its stock for property, labor, or services at an overvaluation, the transaction is illegal under some of the statutory or constitu-

⁶⁹ Garrett v. Kansas City Coal Min. Co., 113 Mo. 330, 20 S. W. 965, 35 Am. St. Rep. 713; Elyton Land Co. v. Birmingham Warehouse & Elevator Co., 92 Ala. 407, 9 So. 129, 12 L. R. A. 307, 25 Am. St. Rep. 65.

⁷⁰ In the case of stock dividends, the holder of such stock may be held

accountable by subsequent creditors in case of an excessive or entirely unwarranted estimate of the profits, where the stockholders have taken the stock dividends with notice of the circumstances. Whitlock v. Alexander, 160 N. C. 465, 76 S. E. 538. See Fletcher, Corporations, sec. 1353.

tional provisions referred to, and, even in the absence of such a provision, is illegal as against dissenting stockholders and subsequent *bona fide* creditors.⁷¹

The stock-watering process.—The obligation to contribute to capital the amount of the par value of stock subscribed is theoretically not discharged by fictitious payment. Very often, however, in order to wash out of the watered or bonus stock the danger of liability to pay up its par value to creditors in event of insolvency, the organizers go through a solemn ceremony of legal hocus pocus which is supposedly sufficient to deceive the fiction-loving eye of the law, and which has become a part of the customary rigmarole of corporate organization and stock issues. The entire authorized capital stock is commonly issued to the promoters by the dummy directors in payment for a mine, a lease, an oil well, a patent, an option, or some other consideration of uncertain value. The fiction consists in the determination by the directors that the value of the property thus acquired is the same as the par value of the stock issued in exchange for it. Even the fact that the promoter, as part of the transaction, graciously donates back to the corporation as "treasury stock" a large portion of the stock for which he has just paid in full, does not indicate to the courts that the valuation of the property is excessive. If the transaction is not too transparent, the stock can now be sold to the public for less than par as fully paid-up and nonassessable stock, although upon an original issue a liability would attach for the unpaid balance.

⁷¹ *Camden v. Stuart*, 144 U. S. 104, 36 L. Ed. 363, 12 Sup. Ct. 585; *Elyton Land Co. v. Birmingham Warehouse & Elevator Co.*, 92 Ala. 407, 9 So. 129, 12 L. R. A. 307, 25 Am. St. Rep. 65; *Sprague v. National Bank of America*, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; *Stout v. Hubbell*, 104 Iowa 499, 73 N. W. 1060; *Wallace v. Carpenter Elec. Heating Mfg. Co.*, 70 Minn. 321, 73 N. W. 189, 68 Am. St. Rep. 530; *Hastings Malting Co. v. Iron Range Brewing Co.*, 65 Minn. 28, 67 N. W. 652; *Wetherbee v. Baker*, 35 N. J. Eq. 501; *Gamble v. Queen's County Water Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527.

Justice Depue, in the case of *Wetherbee v. Baker*, 35 N. J. Eq. 501, 511, says: "The capital stock subscribed is a substitute for the personal liabil-

ity of partners in ordinary copartnerships, and creditors are entitled to a *bona fide* exercise of the compulsory powers of the corporation to compel subscribers to pay in their subscriptions. . . . The courts have inflexibly enforced the rule that payment of stock subscriptions is good as against creditors only where payment has been made in money, or in what may be fairly considered as money's worth (citing authorities). Indeed, courts could not on any other doctrine administer the law of corporations with the immunity of stockholders from responsibility for the debts of the corporation, and the substitution of stock subscriptions in the place of their personal liability, without opening the door for the grossest frauds upon creditors." (Citing and discussing authorities.)

The question then arises, what showing will the courts require to set aside the arrangement as a fraud upon creditors? In some jurisdictions the so-called "*true value rule*" has been adopted by the courts. According to this rule, payment for capital stock with property is no payment except to the extent of the true value of the property. If property is taken at an overvaluation the stockholder is liable to make up the deficiency and perform his obligation to give money or money's worth to the full amount of the par value of the stock taken.⁷² In other jurisdictions a much more lenient standard, called the "*good faith rule*," has been adopted. By this rule the determination by the directors is conclusive unless fraud or intentional or reckless overvaluation can be shown.⁷³ The cases do not make it entirely clear whose good faith is in question in the matter of valuation. Upon the theory of liability based on misrepresentation by the stockholders, it would seem that good faith turns on whether the stockholder was justified in believing, in the exercise of ordinary business sense, that the property was being turned in at a fair valuation. If, on the other hand, it is a question of the performance of an obligation owed to the corporation to contribute to its capital, then the actual and reasonable belief of the directors and officers of the corporation as to the value would seem the test. This seems the one usually applied.⁷⁴

⁷² State Trust Co. v. Turner, 111 Iowa 664, 82 N. W. 1029, 53 L. R. A. 136; Wm. E. Dee Co. v. Proviso Coal Co., 290 Ill. 252, 125 N. E. 24, 26. "Property may be taken in payment for stock, but it must be done by a valid contract of bargain and sale. Payment with property for capital stock is no payment except to the extent of the true value of the property, and if property is taken at an overvaluation the stockholders are liable to make up the deficiency. Farwell v. Great Western Tel. Co., 161 Ill. 522, 44 N. E. 891; Sprague v. National Bank of America, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; Gillett v. Chicago Title & Trust Co., 230 Ill. 373, 82 N. E. 891. The law required the plaintiffs in error, in paying for their stock, to give money or money's worth to the full amount of their subscriptions." See also, Lantz v. Moeller, 76 Wash. 429, 136 Pac. 687, 50 L. R. A. (N. S.) 68; 14 C. J. 961.

⁷³ Coit v. North Carolina Gold Amalgamating Co., 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; Clinton Mining & Mineral Co. v. Jamison, 256 Fed. 597; 14 C. J. 962; 5 Fletcher, Corporations, sec. 3576. See Wickersham, Capital of a corporation, 22 Harvard Law Rev. 319.

⁷⁴ Kaye v. Metz, 186 Cal. 42, 198 Pac. 1047. See Rhode v. Dock-Hop Co., 184 Cal. 367, 194 Pac. 11, 12 A. L. R. 437. Compare Holcombe v. Trenton White City Co., 80 N. J. Eq. 122, 82 Atl. 618. The judgment of directors who issue the stock and who have the duty of valuing the property must be accorded considerable weight, but their judgment is not conclusive. Their honest judgment if reached without due consideration into the elements of value, or if warped by self-interest may invalidate the valuation as surely as would a corrupt motive. See also, Wickersham, The capital of a corporation, 22 Harvard Law Rev. 319.

It was held in an Oregon case that the transfer of certain worthless options as payment for 2,000 shares of common stock to the promoters did not show payment of the par value of \$200,000, in spite of the Oregon statute making the judgment of the directors as to the value of the property taken conclusive. This was so held on the ground that the parties transferring the options to the corporation at such a gross overvaluation were the very parties who pretended to accept the transfer on behalf of the corporation. They alone were in control of the corporation, and therefore the pretended exercise of judgment by the directors, whose personal interest was adverse, was fraudulent and not conclusive upon any creditor of the corporation.⁷⁵ The action of the directors, although assented to by all concerned in the corporation at the time, is not binding as to subsequent creditors who have a right to demand that the capital stock subscribed shall be fully paid up if necessary to meet corporate liabilities, as the fund or resource which is the substitute for individual liability and the basis of credit. Whether the transaction might be questioned by subsequent stockholders is another question.⁷⁶

In a leading New Jersey case the court held that promoters cannot capitalize prospective profits.⁷⁷ The New Jersey statute provided that corporations could purchase property necessary for the business and issue stock to the amount of the value thereof in payment. Defendants had obtained options on various paper mills to purchase the same for about \$2,500,000. In exchange for these mills stocks and bonds to the amount of \$5,000,000 were given. The price was arrived at by capitalizing the annual profits expected to be realized from a favorable marketing of the product of the company by a suppression of competition. It was argued that the price paid was fixed in good faith and the increased valuation was accounted for by the item of good will. It was, however, held that there was a conscious overvaluation.

Some of the courts have held, or seem to have held, that there must be actual fraud and that an overvaluation of property turned over in payment of stock does not of itself render the subscriber

⁷⁵ *Atwell v. Schmitt*, 111 Ore. 96, 225 Pac. 325. Transfer of options by promoters at gross overvaluation, not payment of stock subscription, where director's valuation is made by those adversely interested. As directors they accepted the options in payment of their own stock subscriptions. The

stock was held to be watered. See I Cook, *Corporations* (8th Ed.), sec. 199.

⁷⁶ See ante, § 44a.

⁷⁷ See *v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 843; *Wallace v. Weinstein*, 257 Fed. 625.

liable for the difference between the actual value and the amount of the stock subscribed.⁷⁸ But the weight of authority is to the effect that an actual fraudulent intent is not necessary if the overvaluation was intentional. An intentional overvaluation is fraudulent as matter of law.⁷⁹ If a gross and obvious overvaluation is unexplained, it is conclusive evidence that the overvaluation was intentional and fraudulent.⁸⁰

"Where the nature and condition of the property," said the Minnesota court, "are such that its value is well known and understood, or is capable of being readily estimated and ascertained, and the property is transferred to the corporation at a gross overvaluation for paid-up shares, the transaction is *prima facie* fraudulent as to subsequent creditors, and as against them the burden is upon the shareholders to rebut the presumption by clear and satisfactory evidence. If he knew or ought to have known that he was paying for his stock in property at a material overvaluation, it will not be sufficient for him to show, as a mental operation, that he did not intend to defraud any one. He must go further, and show that, in the exercise of ordinary business sense, he was justified in believing, and did honestly believe, that the property was being turned in at a fair valuation. Where the facts are undisputed, and the overvaluation so great as to show that the stockholder ought to have known it if he had exercised ordinary business prudence, his actual belief or intention in the premises will not avail him; he will be presumed to have intended the reasonable and natural consequences of his act, which is to defraud creditors in case of the insolvency of the corporation."⁸¹

⁷⁸ Coit v. North Carolina Gold Amalgamating Co., 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; Kroenert v. Johnston, 19 Wash. 96, 52 Pac. 605; Coffin v. Ransdell, 110 Ind. 417, 11 N. E. 20.

⁷⁹ Boynton v. Andrews, 63 N. Y. 93; Lake Superior Iron Co. v. Drexel, 90 N. Y. 87; Douglass v. Ireland, 73 N. Y. 100; National Tube Works Co. v. Gilfillan, 124 N. Y. 302, 26 N. E. 538, aff'g 46 Hun (N. Y.) 248; Gates v. Tippecanoe Stone Co., 57 Ohio St. 60, 48 N. E. 285, 63 Am. St. Rep. 705; Elyton Land Co. v. Birmingham Warehouse & Elevator Co., 92 Ala. 407, 9 So. 129, 12 L. R. A. 307, 25 Am. St. Rep. 65; Sprague v. National Bank of America, 172 Ill. 149, 50 N.

E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; Tooker v. National Sugar Refining Co., 80 N. J. Eq. 305, 84 Atl. 10.

⁸⁰ Elyton Land Co. v. Birmingham Warehouse & Elevator Co., 92 Ala. 407, 9 So. 129, 12 L. R. A. 307, 25 Am. St. Rep. 65; Wallace v. Carpenter Elec. Heating Mfg. Co., 70 Minn. 321, 73 N. W. 189, 68 Am. St. Rep. 530; Tooker v. National Sugar Refining Co., 80 N. J. Eq. 305, 84 Atl. 10.

⁸¹ Hastings Malting Co. v. Iron Range Brewing Co., 65 Minn. 28, 67 N. W. 652. This case makes the question turn primarily upon the good faith or constructive fraud of the stockholder making the payment.

A wide margin, however, will always be allowed under the good-faith rule for honest differences of opinion as to value.⁸² And, by the weight of authority, the transaction will be upheld, even as against subsequent creditors, if the valuation was honestly made, although it may appear that there was an error of judgment, and that the valuation was in fact excessive.⁸³ In other words, "the transaction may be impeached for fraud, but not for error of judgment or mistaken views of the value of the property, inasmuch as good faith and the exercise of an honest judgment is all that is required."⁸⁴ This is true, even though it may turn out that the property was in fact very greatly overvalued, if it affirmatively appears that the valuation was in good faith.⁸⁵ If an oil company issues its entire capital stock to the owner of an oil lease as fully paid by the transfer of his lease, the fact that he then turns back one-half of the stock for the purpose of its being used to help raise working capital is said not to be sufficient to raise a presumption that there was fraud in the transaction by which the value of the property was agreed upon. Such simultaneous surrender might, however, be a circumstance tending to show fraud.⁸⁶

By the weight of authority, the fact that the property taken in payment for stock is of such a character that it is not easy to assign to it a determinate value, as in the case of patents and mines, does

See *State Bank of Commerce v. Kenney Band Instrument Co.*, 143 Minn. 236, 173 N. W. 560.

⁸² *Goodman v. White*, 174 N. C. 399, 93 S. E. 906; *Elyton Land Co. v. Birmingham Warehouse & Elevator Co.*, 92 Ala. 407, 9 So. 129, 12 L. R. A. 307, 25 Am. St. Rep. 65; *McBride v. Farrington*, 131 Fed. 797. But compare *See v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 843.

⁸³ *Coit v. North Carolina Gold Amalgamating Co.*, 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; *Grant v. East & West R. Co.*, 54 Fed. 569; *Hastings Malting Co. v. Iron Range Brewing Co.*, 65 Minn. 28, 67 N. W. 652; *Young v. Erie Iron Co.*, 65 Mich. 111, 31 N. W. 814; *Graves v. Brooks*, 117 Mich. 424, 75 N. W. 932; *Woolfolk v. January*, 131 Mo. 620, 33 S. W. 432; *Schenck v. Andrews*, 57 N. Y. 133; *Boynton v. Andrews*, 63 N. Y. 93; *Douglass v. Ireland*, 73 N. Y. 100; *Lake Superior Iron Co. v. Drexel*, 90 N. Y. 87; *Powers v. Knapp*, 85 Hun (N. Y.) 38, 32 N. Y.

Supp. 622, aff'd 158 N. Y. 733, 53 N. E. 1131; *Bickley v. Schlag*, 46 N. J. Eq. 533, 20 Atl. 250; *American Tube & Iron Co. v. Baden Gas Co.*, 165 Pa. St. 489, 30 Atl. 940; *Donald v. American Smelting & Refining Co.*, 62 N. J. Eq. 729, 48 Atl. 771. Compare, however, *State Trust Co. v. Turner*, 111 Iowa 664, 82 N. W. 1029, 53 L. R. A. 136.

⁸⁴ *Douglass v. Ireland*, 73 N. Y. 100; *In re Charles Town Light & Power Co.*, 199 Fed. 846.

⁸⁵ *Young v. Erie Iron Co.*, 65 Mich. 111, 31 N. W. 814, and other cases above cited. Contra, *State Trust Co. v. Turner*, 111 Iowa 664, 82 N. W. 1029, 53 L. R. A. 136.

⁸⁶ *In re Pipe Line Oil Co.*, 289 Fed. 698 (the personal adverse interest of the accepting directors is not to be overlooked in determining the good faith of the valuation); *Clinton Min. Co. v. Jamison*, 256 Fed. 577. See *Sherman v. S. K. D. Oil Co.*, 185 Cal. 534, 197 Pac. 799, 804.

not necessarily render the transaction illegal, if the valuation is really made in good faith.⁸⁷ But payment in a patent right or other property which has no ascertained value is not a payment in money or its equivalent, within the meaning of a statute.⁸⁸ Indeed, it has been held that payment in an invention or patent right, or other property, which turns out to have been absolutely worthless, is not a good payment as against subsequent *bona fide* creditors, even where the parties believed it to be valuable, and that, in such a case, proof of an actual fraudulent intent is not necessary to entitle such creditors to enforce payment.⁸⁹

When a corporation purchases property, and issues its stock in payment, the property is properly valued at what it is actually worth, however much such value may exceed what it cost the vendor, for the cost is not the test of value.⁹⁰ The value at the time of the exchange for stock determines the value of the property, and not the honest belief of the value that the property would have in the future when developed.⁹¹ The good will of a business purchased by a corporation, and paid for by stock, is property, and is to be taken into consideration in determining the value paid for the stock.⁹² The statutory provision that stock shall not be issued except for money, labor done, or money or property actually received, does not prevent a corporation from issuing stock for services to be thereafter performed, if the transaction is *bona fide*.⁹³

⁸⁷ Robbins v. Ideal Wheel & Tire Co., 93 N. J. Eq. 293, 115 Atl. 525; Kunkle v. Soule, 68 Colo. 524, 190 Pac. 536.

"In the absence of fraud, an agreement may ordinarily be made by which stockholders can be allowed to pay for their shares in patents, mines, or other property, to which it is not easy to assign a determinate value." New Haven Horse Nail Co. v. Linden Spring Co., 142 Mass. 349, 7 N. E. 773. But see State Trust Co. v. Turner, 111 Iowa 664, 82 N. W. 1029, 53 L. R. A. 136.

⁸⁸ Tasker v. Wallace, 6 Daly (N. Y.) 364. See also, National Tube Works Co. v. Gilfillan, 46 Hun (N. Y.) 248, aff'd 124 N. Y. 302, 26 N. E. 538; Graves v. Brooks, 117 Mich. 424, 75 N. W. 932.

⁸⁹ Van Cleve v. Berkey, 143 Mo. 109, 44 S. W. 743, 42 L. R. A. 593; Chisholm Bros. v. Forny, 65 Iowa 333, 21 N. W. 664; Henderson v. Turngren, 9 Utah 432, 35 Pac. 495.

And see State Trust Co. v. Turner, 111 Iowa 664, 82 N. W. 1029, 53 L. R. A. 136. Cp. Whitlock v. Alexander, 160 N. C. 465, 76 S. E. 538.

⁹⁰ Grant v. East & West R. Co., 54 Fed. 569; Commonwealth v. Central Passenger R. Co., 52 Pa. St. 506; Hasson v. Koeberle, 180 Cal. 359, 181 Pac. 387.

⁹¹ Herron Co. v. Shaw, 165 Cal. 668, 133 Pac. 488; See v. Heppenheimer, 69 N. J. Eq. 36, 61 Atl. 843.

⁹² Washburn v. National Wall-Paper Co., 81 Fed. 17; Brown v. Weeks, 195 Mich. 27, 161 N. W. 945; Kunkle v. Soule, 68 Colo. 524, 190 Pac. 536. Compare Camden v. Stuart, 144 U. S. 104, 36 L. Ed. 363, 12 Sup. Ct. 585. See also, Hodde v. Hahn, 283 Mo. 320, 222 S. W. 799.

⁹³ Shannon v. Stevenson, 173 Pa. St. 419, 34 Atl. 218. But see Morgan v. Bon Bon Co., 222 N. Y. 22, 28, 118 N. E. 205. It is held in Scully v. Automobile Finance Co., 12 Del. Ch.

Nominal or fictitious contribution of capital.—Although a corporation may contract with its stockholders, and lend them money if it acts in good faith and without prejudice to the rights of creditors, it cannot resort to any such device for the purpose of relieving them from payment for their shares, to the injury of creditors. It was held, therefore, in a leading case in the Supreme Court of the United States, that an arrangement by which the stock of a corporation was nominally paid for by the subscribers, and the money was immediately repaid as a loan to them, was a mere device to change the subscribers' indebtedness from a stock debt to a loan, and was not a valid payment as against creditors of the corporation.⁹⁴ An arrangement by which each subscriber to stock is given a bond of equal amount as a bonus would have the legal effect of throwing the risks of the business on the public who may deal with the corporation. Each subscriber would have the obligation of the company, secured by a primary mortgage that he should be repaid the amount of his subscription with interest in event the enterprise proved unprofitable; but the stockholders would reap all possible gains in event of success. Such a scheme would be invalid either as to existing or subsequent creditors.⁹⁵

§ 208. Statutory or constitutional provisions against fictitious payment.

The charter of particular corporations, or the general law under which they are formed, sometimes expressly provides that they shall not issue their stock for less than its par value. And in many states, to prevent the evils arising from the issue of watered or fictitiously paid-up stock, and protect the public who may purchase stock or become creditors of corporations, general constitutional or statutory prohibitions have been adopted or enacted. In a number of states it is provided, in substance, that no corporation shall issue stock or bonds "except for labor done or money or property actually received," and that "all fictitious

174, 109 Atl. 49, that services to be rendered cannot be a valid consideration for the issuance of full paid, non-assessable shares, for these can be issued under the constitution of Delaware, only for "labor done." This does not mean that shares may not be issued for services to be rendered so long as they are not marked fully paid; and the stock will be subject to assessment either by the corporation

or for the benefit of creditors up to the par value thereof.

⁹⁴ *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 L. Ed. 731.

⁹⁵ *Guarantee Trust Co. v. Dilworth Coal Co.*, 235 Pa. 594, 84 Atl. 516; *Morrow v. Nashville Iron & Steel Co.*, 87 Tenn. 262, 10 S. W. 495, 3 L. R. A. 37, 10 Am. St. Rep. 658; *Bolapp v. Ogden N. W. R. Co.*, 37 Utah 540, 110 Pac. 364.

increase of stock or indebtedness shall be void." In some, the labor or property is expressly required to be received at no greater value than the market price. Some of the provisions are so clear as to leave no doubt as to the intention of the legislature, while in construing others the courts have not agreed.

The common provision that no corporation "shall issue stock or bonds except for money or property actually received or labor done, and that all fictitious increase of stock or indebtedness shall be void" is difficult to interpret and apply. Most of the courts, in construing this prohibition, have held that it is intended to protect stockholders against spoliation, and to guard the public against securities that are worthless, by preventing the flooding of the market with stock and bonds which do not represent anything whatever of substantial value; and that it was not intended to make the validity of every issue of stock or bonds by a private corporation depend upon the inquiry whether the money, property, or labor received therefor was of equal value in the market with the stock or bonds so issued.⁹⁶ It is aimed against stock-watering, but fails to lay down any test of what is or is not "fictitious."⁹⁷

In California and some of the states, under the constitutional or statutory provision that no corporation shall issue stock except for money paid, labor done, or property actually received, and that all fictitious increase of stock shall be void, it is held that certificates of stock issued for nothing are absolutely null and void, even as between the parties, and that they do not make the persons to whom they are issued stockholders, or confer any rights or impose any liabilities upon them as such.⁹⁸ If stock is issued contrary to

⁹⁶ Statutes which forbid the issue of par value stock for overvalued property or without adequate consideration are usually construed not to make the transaction utterly void. If so, the alleged subscribers might escape liability to creditors for the balance of the par value unpaid. The payment actually made is treated only as a payment on account. The liability to pay the balance is imposed by law. Warren, 34 Harvard Law Rev. 287. See Perkins v. Cowles, 157 Cal. 625, 108 Pac. 711, 30 L. R. A. (N. S.) 283, 137 Am. St. Rep. 158; Memphis & Little Rock R. Co. v. Dow, 120 U. S. 287, 30 L. Ed. 595, 7 Sup. Ct. 482; Peoria & S. R. Co. v. Thompson, 103 Ill. 187; Stein v. Howard, 65 Cal. 616, 4 Pac. 662; Kellerman v. Maier,

116 Cal. 416, 48 Pac. 377; Nelson v. Hubbard, 96 Ala. 238, 11 So. 428, 18 L. R. A. 260; People v. Union Consol. El. R. Co., 263 Ill. 32, 105 N. E. 12, Ann. Cas. 1915 C 388. See 87 Am. St. Rep. 847 note.

⁹⁷ These ill-advised statutory and constitutional provisions declaring apparently that watered stock shall be void would be so disastrous in their effects upon creditors and upon innocent purchasers of corporate securities that courts have found it necessary to construe away the language and render it almost without any practical effect. See Cook, Corporations (8th Ed.) sec. 47.

⁹⁸ J. F. Lucey Co. v. McMullen, 178 Cal. 425, 173 Pac. 1000; Clark v. Millsap, 197 Cal. 765, 242 Pac. 918,

the statute without being properly paid for, the better view is that the stock is not void. The agreement to issue it without payment or for less than par is invalid, and the subscription stands as though the bonus feature had been omitted, leaving in force the obligation to pay for the stock when required by the corporation, or at least when needed to pay creditors.⁹⁹ In *Collier v. Edwards*,¹⁰⁰ the Oklahoma court points out that this provision of the constitution against fictitious stock is intended to protect the public, and that it certainly was not intended that it could be invoked by the original subscribers to whom stock had been issued without payment as a weapon of defense in an action by a creditor of the corporation against such shareholder, thereby permitting a delinquent subscriber and the corporation to perpetrate a fraud. The holder cannot set up the invalidity of the stock to escape liability.

So long as a contract by a corporation to issue stock at a discount, or for property or services to be taken at an overvaluation, is wholly executory, it is void, and it cannot be enforced either by or against the corporation.¹⁰¹ But if stock is actually issued at a discount for cash, in violation of an express statutory prohibition,

923; *Kellerman v. Maier*, 116 Cal. 416, 48 Pac. 377; *Jefferson v. Hewitt*, 103 Cal. 624, 37 Pac. 638; *Beitman v. Steiner Bros.*, 98 Ala. 241, 13 So. 87; *Arkansas River Land, Town & Canal Co. v. Farmers' Loan & Trust Co.*, 13 Colo. 587, 22 Pac. 954; *Clarke v. Lincoln Lumber Co.*, 59 Wis. 655, 18 N. W. 492; *Hinckley v. Pfister*, 83 Wis. 64, 53 N. W. 21; *Overlock v. Jerome-Portland Copper Min. Co.*, — Ariz. —, 243 Pac. 400 (even *bona fide* purchaser cannot compel recognition); *Kanamán v. Gahagan*, 111 Tex. 170, 230 S. W. 141; *Tramp v. Marquesen*, 188 Iowa 968, 176 N. W. 977; *Pruett v. Cattlemen's Trust Co.* (Tex. Comm. App.), 222 S. W. 533; *Lavell v. Bullock*, 43 N. D. 135, 174 N. W. 764.

In California, bonus stock for which no valid consideration whatever has been paid is held void under the statute even as against creditors. This presents an absurd distinction. "If a person receives bonus stock for which no consideration has been paid, he goes scot-free of liability, but if he is unfortunate enough to have paid as much as one single dollar for each share, he is presumably liable for the

remaining ninety-nine dollars." *Bonbright*, 25 Columbia Law Rev. 428.

⁹⁹ *Scully v. Automobile Finance Co.*, 12 Del. Ch. 174, 109 Atl. 49; *Rosoff v. Gilbert Transp. Co.*, 221 Fed. 972, 986; 25 Columbia Law Rev. 428; 21 Yale Law Journal 883, 886.

¹⁰⁰ 109 Okla. 153, 234 Pac. 720. See also, *Du Pont v. Ball*, 11 Del. Ch. 430, 106 Atl. 39, 7 A. L. R. 955; *Rubber Tire Supply Co. v. American Utilities Co.*, — Mo. App. —, 279 S. W. 751, 755; *Gray Const. Co. v. Hyde*, — S. D. —, 207 N. W. 536.

¹⁰¹ *Ecuadorian Ass'n v. Ecuador Co.*, 71 N. J. Eq. 757, 65 Atl. 1051; *Edgerton v. Electric Improvement & Construction Co.*, 50 N. J. Eq. 354, 24 Atl. 540; *Garrett v. Kansas City Coal Min. Co.*, 113 Mo. 330, 20 S. W. 965, 35 Am. St. Rep. 713; *Clarke v. Lincoln Lumber Co.*, 59 Wis. 655, 18 N. W. 492; *Zelaya Min. Co. v. Meyer*, 28 N. Y. St. Rep. 759, 8 N. Y. Supp. 487; *Williams v. Evans*, 87 Ala. 725, 6 So. 702, 6 L. R. A. 218; *West Cornwall Ry. Co. v. Mowatt*, 12 Jur. 407; *Rogers v. Gross*, 67 Minn. 224, 69 N. W. 894. See *In re Almada & Tiritto Co.*, L. R. 38 Ch. Div. 415; 5 Fletcher, Corporations, sec. 3584, p. 5909.

the issue of the stock is not void, but the agreement that it shall be paid for at less than its par value is illegal and void, and cannot be enforced. In such a case, the subscriber or purchaser is liable for the full par value.¹⁰² So when property is conveyed to a corporation in payment for stock, and certificates issued to the subscribers or purchasers, the fact that the property is overvalued does not render the transaction void, even when there is a constitutional or statutory provision that no corporation shall issue stock except at its par value, for money, labor, or property estimated at its true value, and actually received, and that all fictitious increase of stock shall be void. As between the corporation and its stockholders, it cannot be claimed that the property conveyed by them to it in payment for their stock was not a sufficient consideration.¹⁰³ But as to creditors, the adequacy of the consideration is open to scrutiny.

Bonds, unlike stock, may be issued for less than face value.¹⁰⁴ Bondholders are not owners but creditors of the enterprise. They do not enjoy the privilege of sharing the profits with limited liability and so do not come under an obligation to contribute a specified amount to the capital. Under some statutes, however, bonds are declared void if issued at less than a certain per cent of their face value.¹⁰⁵ In some jurisdictions, to prevent a fictitious increase of their indebtedness by corporations, it is provided that a corporation shall not issue bonds except for money paid, labor done, or property actually received, and that all fictitious increase of indebtedness shall be void, and bonds issued in violation of this provision are void, unless they have passed into the hands of a *bona fide* purchaser for value. Under such a provision a corporation has no power to give away its bonds, or to sell them on credit,

¹⁰² *In re Railway Time Tables Pub. Co.*, [1895] 1 Ch. 225, aff'd *Welton v. Saffery*, [1897] App. Cas. 299; *R. H. Herron Co. v. Shaw*, 165 Cal. 668, 133 Pac. 488, Ann. Cas. 1915 A 1268. But see contra, *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429.

¹⁰³ *Whitehill v. Jacobs*, 75 Wis. 474, 44 N. W. 630; *Wells v. Green Bay & M. Canal Co.*, 90 Wis. 442, 64 N. W. 69; *Nierosi v. Irvine*, 102 Ala. 648, 15 So. 429, 48 Am. St. Rep. 92. And see *Arapahoe Cattle & Land Co. v. Stevens*, 13 Colo. 534, 22 Pac. 823; *Woolfolk v. January*, 131 Mo. 620, 33 S. W. 432; *Vineland Grape Juice Co.*

v. Chandler, 80 N. J. Eq. 437, 85 Atl. 213, Ann. Cas. 1914 A 679.

¹⁰⁴ *Clearwater County State Bank v. Bagley-Ogema Tel. Co.*, 116 Minn. 4, 133 N. W. 91, 36 L. R. A. (N. S.) 1132, Ann. Cas. 1913 A 622; *Pueblo Foundry & Machine Co. v. Lannon*, 68 Colo. 131, 187 Pac. 1031.

¹⁰⁵ *In re Valecia Condensed Milk Co.*, 233 Fed. 173; *Thompson, Corporations*, secs. 2241, 2246. See *Guaranty Title & Trust Co. v. Dilworth Coal Co.*, 235 Pa. 594, 84 Atl. 516; *National Foundry & Pipe Works v. Oconto Water Co.*, 52 Fed. 29; *Pfister v. Milwaukee Elec. Ry. Co.*, 83 Wis. 86, 53 N. W. 27.

or otherwise dispose of them except for a present consideration, and for a corporate purpose.^{105a} To bring a case within the prohibition, it must appear that the corporation has fraudulently issued, or is about to fraudulently issue and put upon the market, bonds which do not represent, and are not intended to represent, money or property received. It does not prevent a corporation from disposing of its bonds for the best price which it can obtain, though it may be less than par. Nor does it require that bonds and the property or labor for which they are issued shall be of equal market value.^{105b}

§ 209. Validity of bonus or watered stock as against the corporation.—By the great weight of authority, in the absence of express charter, statutory, or constitutional provisions establishing a different rule, an issue of watered or fictitiously paid-up stock by a corporation, whether the issue was at a discount of its par value, or for property, labor, or services taken at an intentional overvaluation, or gratuitous, is binding upon the corporation, and as against all other parties, except in so far as it may constitute a violation of the rights of existing stockholders, or operate as a fraud upon subsequent subscribers for stock, or subsequent creditors of the corporation.

For a corporation to issue its stock as full-paid upon payment of less than its par value is perfectly valid as between the parties, if all the stockholders consent, and the corporation cannot afterwards repudiate the agreement, and compel payment of the difference between the par value of the stock and what it has agreed upon as payment in full. In a leading case on this point, decided in 1881 in the Supreme Court of the United States, a corporation organized under the laws of Kansas, where there was no express statutory or constitutional provision on the subject, issued its stock to all of its subscribers as full-paid, upon payment of less than half of its par value, and agreed with them that no further payment should be required. The court held that the agreement was *valid and binding* as between the corporation and the stockholders, although the stockholders might be required in equity to

^{105a} Peoria & S. R. Co. v. Thompson, 103 Ill. 187, 202.

^{105b} Memphis & Little Rock R. Co. v. Dow, 120 U. S. 287, 30 L. Ed. 595, 7 Sup. Ct. 482; Brown v. Duluth, M. & N. Ry. Co., 53 Fed. 889; Peoria

& Springfield R. Co. v. Thompson, 103 Ill. 187; Nelson v. Hubbard, 96 Ala. 238, 11 So. 642; Underhill v. Santa Barbara Land, Bldg. & Imp. Co., 93 Cal. 300, 28 Pac. 1049.

pay such part of the difference between the par value of the stock and the amount paid as might be necessary to satisfy the claims of creditors of the corporation.

"The stock held by the defendant," said the court, "was evidenced by certificates of full-paid shares. It is conceded to have been the contract between him and the company that he should never be called upon to pay any further assessments upon it. The same contract was made with all the other shareholders, and the fact was known to all. As between them and the company *this was a perfectly valid agreement. It was not forbidden by the charter or by any law or public policy*, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter. If the company, for the purpose of increasing its business, had called upon the stockholders to pay up that part of their stock, which had been satisfied 'by discount' according to their contract, they could have successfully resisted such a demand. No suit could have been maintained by the company to collect the unpaid stock for such a purpose. The shares were issued as full-paid, on a fair understanding, and that bound the company." ¹⁰⁶

The same is true, by the weight of authority, when a corporation issues its stock for property, labor, or services, whether it issues the same at less than par upon a fair valuation of the property, labor, or services, or at par upon an overvaluation. If the transaction is unaffected by charter, statutory, or constitutional provisions, and all the stockholders consent, and the rights of creditors are not involved, the transaction is perfectly valid and binding as between the parties. As between them, the courts will treat the stock as full-paid, in accordance with their agreement, however much the par value of the stock may exceed the value of the property, labor, or services. "Whatever," said Judge Showalter in a federal case, "may have been in fact the value of the property turned over to the company for its stock, the company agreed to take it for the stock. The persons interested were the stockholders, and there was no dissent on the part of the person concerned from

106 *Scoville v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *Great Western Min. & Mfg. Co. v. Harris*, 128 Fed. 321, 330; *Barr v. New York, L. E. & W. R. Co.*, 125 N. Y. 263, 26 N. E. 145; *Flynn v. Brooklyn City R. Co.*, 9 N. Y. App. Div. 269, 41 N. Y. Supp. 566; *Hill v. Atoka Coal & Mining*

Co., 124 Mo. 153, 25 S. W. 926, 32 S. W. 111; *Vasey v. New Export Coal Co.*, 89 W. Va. 491, 109 S. E. 619; *Northwest Nat. Motor Car Co. v. McConnell*, 153 Minn. 398, 190 N. W. 608; *Fletcher, Corporations*, *secs.* 3518, 3533.

what was then done. Neither any person then holding stock, nor any person who afterwards became a stockholder by assignment from one who then held stock, can now make complaint, on behalf of the corporation, as against the fairness of that transaction. This I take to be the settled law on that subject."¹⁰⁷

Innocent subscribers or purchasers who pay full value may have a right of action in some states to cancel stock fraudulently issued for an inadequate consideration, especially as against a promoter. For a corporation to issue its stock gratuitously or at a discount violates the rights of existing stockholders who do not consent, and is a fraud upon subsequent subscribers, and upon subsequent creditors who deal with it on the faith of its capital stock. The former may sue to enjoin the issue of the stock, or to cancel it if it has been issued, and has not reached the hands of a *bona fide* purchaser.¹⁰⁸ Subsequent creditors, according to the weight of authority, may compel payment by the person to whom it was issued, to such extent as may be necessary for the payment of their claims.¹⁰⁹

The issue of the stock, however, or at least the agreement not to require payment, is binding as between the corporation and the other party, unless it is in violation of some charter, statutory, or constitutional provision, and the corporation itself cannot repudiate the agreement and compel payment therefor.¹¹⁰ A corporation

¹⁰⁷ Northern Trust Co. v. Columbia Straw Paper Co., 75 Fed. 936, aff'd Dickerman v. Northern Trust Co., 80 Fed. 450. And see Whitehill v. Jacobs, 75 Wis. 474, 44 N. W. 630; Van Cott v. Van Brunt, 82 N. Y. 535; Barr v. New York, L. E. & W. R. Co., 125 N. Y. 263, 26 N. E. 145; Higgins v. Lansingh, 154 Ill. 301, 40 N. E. 362.

In Robins v. Ideal Wheel & Tire Co., 93 N. J. Eq. 293, 295, 115 Atl. 525, it is said: "Here the contest is between the corporation and its stockholders, or more closely speaking between the stockholders, and the rigid requirements of the statute for the protection of creditors are not applicable." Vasey v. New Export Coal Co., 89 W. Va. 491, 109 S. E. 619.

¹⁰⁸ See ante, § 44a, note. Liability for payments on stock issued for overvalued property, or for property not legal payment, 31 Yale Law Journal 883, 884.

If the corporation consists of those who assented to the illegal issue plus the other innocent shareholders who

have paid full value for their shares, the latter should either in their own name or in that of the corporation be able to sue to cancel the issue. Frame v. Mahoney, 21 Ariz. 282, 187 Pac. 584. See Whitewater Tile & Pressed Brick Mfg. Co. v. Johnson, 171 Wis. 82, 175 N. W. 786; Winters v. Lindsay, 52 Cal. App. 93, 198 Pac. 43. Cp. Scully v. Auto Finance Co., 12 Del. Ch. 174, 109 Atl. 49.

¹⁰⁹ Post, § 210; Handley v. Stutz, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; Fletcher, Corporations, sec. 3520.

¹¹⁰ Christensen v. Eno, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429. One to whom shares of stock in a corporation have been issued, upon which 40 per cent of their nominal amount was not paid, but was credited as paid when the stock was issued to him, does not become a debtor to the company or make himself liable to pay the nominal face of the shares as upon a subscription. This is so held in New York even as against creditors of the corporation.

free from indebtedness, if acting in good faith, has the power, as between itself and its stockholders, if all consent, to agree, in consideration of the surrender by the stockholders to it of accumulated profits, and of the increased value of its property, to treat stock, upon which only fifty per cent has been paid, as fully paid-up stock; and the corporation cannot afterwards, on its own behalf, or on behalf of subsequent creditors with notice, disturb the arrangement, and compel payment of the other fifty per cent of the stock.¹¹¹

§ 210. Liability to creditors on account of bonus or watered stock.—The liability of stockholders to or for the benefit of creditors when a corporation has issued watered or fictitiously paid-up stock has been rested on various theories which are more or less artificial, such as the trust fund and the fraud or holding out theory. A few jurisdictions make liability to creditors depend on liability to the corporation.

Liability to creditors.—Since the capital stock of a corporation is the basis of its credit, persons dealing with a corporation have a right to assume that the full par value of the stock has been actually paid in or will be paid in, so that it will be available for the payment of corporate debts; and it follows that any secret agreement between a corporation and subscribers for or purchasers of its capital stock to issue the stock as full-paid, when in fact it is issued gratuitously, or on payment in part only, will be invalid against persons who subsequently become creditors of the corporation on the faith of its capital stock being fully paid, and they will be entitled to appropriate relief in a court of equity. By the weight of authority, as we shall see, a court of equity will treat the secret agreement as a nullity, and compel full payment for the stock to such an extent as may be necessary to satisfy the claims of such creditors.¹¹²

Some jurisdictions make the right of the creditor against the stockholder depend upon the contract, express or implied, with the corporation.

¹¹¹ *Kenton Furnace Railroad & Mfg. Co. v. McAlpin*, 5 Fed. 737.

¹¹² *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 L. Ed. 731; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; *Coleman v. Howe*,

154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Wetherbee v. Baker*, 35 N. J. Eq. 501; *First Nat. Bank of Deadwood v. Gustin Minerva Consol. Min. Co.*, 42 Minn. 327, 44 N. W. 198, 6 L. R. A. 676, 18 Am. St. Rep. 510;

It was formerly held in England that, where stock was issued by a corporation as full-paid upon payment of less than its par value, and the corporation afterwards became insolvent, and was wound up, the court could not compel the holders of the stock to pay up, for the benefit of creditors of the corporation, the difference between the par value of the stock and the amount actually paid in. The decisions proceeded upon the ground that, if the transaction was invalid, because *ultra vires* or in fraud of subsequent creditors, it was invalid *in toto*; that the court could set it aside altogether, requiring the stock to be returned to the corporation, and what was paid therefor, if anything, returned to the stockholders; but that it could not alter the agreement between the corporation and the stockholders, and substitute or create an agreement to pay the full par value of the shares.¹¹³ In the later cases, however, the English courts have repudiated this doctrine, and it has been held by the House of Lords, as well as by the lower courts, that where a corporation illegally issues its stock for less than par, the stockholders, upon the insolvency and winding up of the company, may be compelled to pay the full par value, if necessary for the payment of creditors.¹¹⁴

The New York courts deny that there is any common-law liability on stock issued at a discount or on watered stock. As is said in the case of *Christensen v. Eno*:¹¹⁵ "But the liability of a shareholder to pay for stock does not arise out of his relation, but depends upon his contract, express or implied, or upon some statute. . . . We do not perceive how a person to whom shares have been issued as a gratuity has, by accepting them, committed any wrong upon creditors, or made himself liable to pay the

Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637.

¹¹³ *In re British Provident Life & Guarantee Ass'n*, 5 Ch. Div. 306; *In re Great Northern & Midland Coal Co.*, 3 De Gex, J. & S. 367; *In re Ince, etc., Mills Co.*, 23 Ch. Div. 545n.

In an article entitled, "The Trust Fund Theory and Some Substitutes for it," Mr. Edwin S. Hunt comes to the conclusion that there is no principle of law or of equity upon which a creditor can compel a stockholder to pay more for his stock than he has agreed to pay. He believes that the liability of stockholders beyond their agreements is a matter for statutory regulation, in accordance with the

New York view; that unissued stock is not assets and that a person accepting shares as a gratuity or at a discount has not injured the creditors, prior or subsequent. 12 Yale Law Journal 63, 81. See also, Wickersham. The capital of a corporation, 22 Harvard Law Rev. 319, 322.

¹¹⁴ *Ooregum Gold Min. Co. v. Roper*, [1892] App. Cas. 125, 66 Law T. 427; *In re Addlestone Linoleum Co.*, 37 Ch. Div. 191; *In re Railway Time Tables Pub. Co.*, [1895] 1 Ch. 255, aff'd *Welton v. Saffery*, [1897] App. Cas. 299.

¹¹⁵ 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429. See *Phelan v. Hazard*, 5 Dill. 45, Fed. Cas. No. 11068; *Van Cott v. Van Brunt*, 82 N. Y. 535.

nominal face of the shares as upon a subscription or contract." It seems then that by the law of New York (although recognizing the trust fund doctrine) the subscription agreements are the source and measure of the duty of the subscribers.¹¹⁶

It is important to observe that there are two sorts of liability to pay upon stock not paid for dollar for dollar at the time of issue. The first is a contractual obligation of the stockholder to the corporation to pay the agreed subscription price or any unpaid instalment thereof. It is clear that the "indebtedness of stockholders upon subscriptions to stock held by them is an indebtedness, not to the creditors of the corporation, but to the corporation itself. Such indebtedness is an asset of the corporation." ¹¹⁷ The second kind of liability has a different basis. It is the source or basis of the obligation to creditors to pay up the par value of bonus or watered stock contrary to the actual agreement, which it is difficult to explain. Most courts recognize that there is such a liability upon the original holders of bonus or watered stock or their transferees with notice. There is much difference of opinion, however, as to the principle or theory upon which this liability to creditors rests and

¹¹⁶ *Southworth v. Morgan*, 205 N. Y. 293, 98 N. E. 490, 51 L. R. A. (N. S.) 56. The C corporation was organized under New Jersey law. It issued two shares of stock to defendant who agreed to pay 25 per cent of the nominal value of the shares. The company failed and the trustee in bankruptcy sues for the other three-fourths of the par value. There was no evidence as to the New Jersey statute law on the subject and the court assumed that the common law of New Jersey was the same as the common law of New York and held that the subscription agreements are the source and measure of the duty of the subscribers. The defendant has fulfilled his obligation and thereby destroyed his liability. But see *Warren*, 34 *Harvard Law Rev.* 286.

Jeffery v. Selwyn, 220 N. Y. 77, 115 N. E. 275, 6 A. L. R. 1111: "The trust fund doctrine as applied to stock subscriptions is not recognized in New York and the contractual liability for stock subscriptions alone is enforced; that is, except for statutory liabilities, creditors can collect no more from the stockholder than he agreed to pay the corporation for his stock." *Southworth v. Mor-*

gan, 205 N. Y. 293, 98 N. E. 490, 51 L. R. A. (N. S.) 56.

But where stock purports to have been fully paid, but by reason of an improper allowance of credit for work, labor, and services, it is not fully paid, it is said that the stockholder owes to the corporation as a debt the difference between the amount lawfully paid and the par value of the stock. This is put on the trust fund theory and the ground that creditors extend credit to the corporation on the faith of its capital. *Palmer v. Scheftel*, 194 N. Y. App. Div. 682, 186 N. Y. Supp. 84, aff'd 236 N. Y. 511, 142 N. E. 263; *Whalen v. Hudson Hotel Co.*, 183 N. Y. App. Div. 316, 170 N. Y. Supp. 855. See *Bottlers' Seal Co. v. Rainey*, 243 N. Y. 833, 153 N. E. 437.

¹¹⁷ *In re People's Livestock Ins. Co.*, 56 Minn. 180, 185, 57 N. W. 468; *Stoddard v. Lum*, 159 N. Y. 265, 273, 53 N. E. 1108, 45 L. R. A. 551, 70 Am. St. Rep. 541 (a contractual liability which is enforceable at law by the corporation or its representatives, and enures to the benefit of its creditors); 5 *Fletcher, Corporations*, sec. 8455.

whether it should be limited to subsequent creditors without notice. This liability has been accounted for on various theories: First, upon the trust fund theory originated by Judge Story in 1824 in the case of *Wood v. Dummer*; ¹¹⁸ second, the fraud theory, the presumed reliance of the creditor upon the issued capital stock of the corporation; ¹¹⁹ third, the codebtor theory, to the effect that the stockholders are in reality codebtors up to the limit set by the par value; ¹²⁰ and fourth, the prescribed obligation theory, that an obligation to contribute an amount equal to the par value is imposed by operation of law as an incident of acquiring membership in a corporation. ¹²¹

§ 211. Trust fund theory.

The capital of a corporation may perhaps be regarded as a trust fund in the sense that it cannot be diverted or distributed among the stockholders without provision being first made for full payment of corporate debts. ¹²² As said by Mr. Pomeroy: ¹²³ "These statements may be sufficiently accurate as strong modes of expressing the doctrine that such property is a fund sacredly set apart for the payment of partnership and corporation creditors, before it can be appropriated to the use of individual partners or corporators."

The principal office of the trust fund doctrine is to preserve the assets of a corporation as a fund for the payment of its debts against withdrawal by stockholders. ¹²⁴ It fails to explain the right of creditors where the corporation has no res to hold in trust,

¹¹⁸ 3 Mason (C. C.) 308, Fed. Cas. No. 17944. In *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968, it was said: "The reason is, that the stock subscribed is considered in equity as a trust fund for the payment of creditors. . . . It is so held out to the public, who have no means of knowing the private contracts made between the corporation and its stockholders. The creditor has, therefore, the right to presume that the stock subscribed has been or will be paid up, and if it is not, a court of equity will at his instance require it to be paid." See also, *Lantz v. Moeller*, 76 Wash. 429, 136 Pac. 687, 50 L. R. A. (N. S.) 68; *Bernard v. Carr*, 167 N. C. 481, 83 S. E. 816; *Brooks v. Buys*, 217 Mich. 263, 186 N. W. 472.

¹¹⁹ *Hospes v. Northwestern Mfg. &*

Car Co., 48 Minn. 174, 50 N. W. 1117, 31 Am. St. Rep. 637, 15 L. R. A. 470.

¹²⁰ 56 Univ. Pennsylvania Law Rev. 57, Pepper.

¹²¹ Pepper, 34 Amer. Law Reg. (N. S.) 448, 457; 29 Harvard Law Rev. 857; Warren, 34 Harvard Law Rev. 287; Ballantine, *Stockholder's Liability in Minnesota*, 7 Minnesota Law Rev. 79.

¹²² *Lebens v. Nelson*, 148 Min. 240, 245, 181 N. W. 350; *Mackall v. Pockock*, 136 Minn. 8, 161 N. W. 228, L. R. A. 1917 C 390, 397.

¹²³ 3 Pomeroy, *Eq. Jur.* (4th Ed.), sec. 1046.

¹²⁴ *Upham v. Bramwell*, 105 Ore. 597, 209 Pac. 100, 121, 210 Pac. 706, 25 A. L. R. 919; *Mackall v. Pockock*, 136 Minn. 8, 12, 161 N. W. 228, L. R. A. 1917 C 390.

no asset or right against the stockholder such as a contract to pay the par value. A trust may be impressed upon unpaid subscriptions to stock, but where the stockholder is under no subscription contract to the corporation itself what is there for the corporation to hold in trust?¹²⁵ Issuing shares wholly or partly as a bonus is not a disposition of corporate assets like paying dividends out of capital, because unissued stock is no asset. The statement of authorized capital stock in the certificate or articles creates merely authority to raise capital to that amount.

§ 212. Fraud or holding out theory.

In the leading case of *Hospes v. Northwestern Mfg. & Car Co.*,¹²⁶ Judge Mitchell, in one of his most celebrated opinions, criticized the trust fund theory as a foundation of the stockholder's liability on watered or bonus stock. He placed this liability on the basis of fraud, actual or constructive.¹²⁷ According to Judge Mitchell the right of creditors to compel holders of bonus stock to pay for it, contrary to their actual agreement with the corporation, rests neither upon implied contract nor upon any trust fund doctrine, but upon the ground of fraud. The fraud consists in the misrepresentation as to the actual amount of capital, upon the faith of which persons have dealt with a corporation and given it credit. Any arrangement between the stockholders of a corporation and the corporation, by which the former are to pay nothing at all, or less than par, either in money or property, for shares of stock which are issued and represented to the public as being full-paid, is a fraud upon persons who deal with the corporation on the faith of such representation, and a court of equity, to prevent creditors from being defrauded, will compel the stockholders to make their representation good. As we shall presently see, creditors not defrauded cannot complain. The capital of a

125 *O'Bear Jewelry Co. v. Volfer*, 106 Ala. 205, 17 So. 525, 528, 28 L. R. A. 707, 54 Am. St. Rep. 31; 20 Harvard Law Rev. 401; 6 Fletcher, Corporations, sec. 4095.

126 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637.

127 *Hospes v. Northwestern Mfg. & Car Co.*, 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637; *O'Bear Jewelry Co. v. Volfer*, 106 Ala. 205, 17 So. 525, 28 L. R. A. 707, 54 Am. St. Rep. 31; *Hastings*

Malting Co. v. Iron Range Brewing Co., 65 Minn. 28, 67 N. W. 652; *First Nat. Bank of Deadwood v. Gustin Minerva Consol. Min. Co.*, 42 Minn. 327, 44 N. W. 198, 6 L. R. A. 676, 18 Am. St. Rep. 510; *Rhode v. Dock-Hop Co.*, 184 Cal. 367, 194 Pac. 11, 12 A. L. R. 437. See *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 37 L. Ed. 1113, 14 Sup. Ct. 127; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530.

corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of it. They have a right to assume that it has paid-in capital of the amount which it represents itself as having; and if they give it credit on the faith of that representation, and if the representation is false, it is a fraud upon them; and in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to the delinquent stockholder, "Make that representation good by paying for your stock."

It follows from the fraud theory that it is only those creditors who have relied, or who can fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce a claim against the holders of "bonus" stock.¹²⁸ Probably the most important consequence of the fraud or holding out theory is the limitation of the stockholders' liability on watered or bonus stock to subsequent creditors without notice. This limitation is observed in a majority of jurisdictions.¹²⁹ But in some states the creditor may recover from the stockholder even though he extended credit prior to the issue of the stock or with full knowledge that the subscription was not paid in full.¹³⁰ This result is usually based in part at least on statutory construction. But it could also be reached as a matter of common law if the right of the creditor is really derived through a prescribed obligation

¹²⁸ *Hospes v. Northwestern Mfg. & Car Co.*, 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637; *Randall Printing Co. v. Sanitas Mineral Water Co.*, 120 Minn. 268, 139 N. W. 606, 43 L. R. A. (N. S.) 706.

Upon the fraud theory only those creditors can assert liability of stockholders who might have been deceived by the fictitious stock issue. There are therefore two classes of creditors who cannot complain: (a) creditors who extended credit prior to the issue of watered stock and so could not have been misled; and (b), creditors who had notice of the fictitious payment. 25 *Columbia Law Rev.* 408, 420.

¹²⁹ See *Minnesota* cases cited above; also *Sherman v. Harley*, 178 Cal. 584, 174 Pac. 901, 7 A. L. R. 950; *Hill v. Silvey*, 81 Ga. 500, 8 S. E. 808, 3 L. R. A. 150; *First Nat. Bank of Chanute v. Northup*, 82 Kan. 638, 109 Pac. 672, 136 Am. St. Rep.

119; *Scott v. Luehrmann*, 278 Mo. 638, 213 S. W. 855; *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123, 154, 28 S. W. 668, 26 L. R. A. 509, 45 Am. St. Rep. 700. But see *Jones v. Whitworth*, 94 Tenn. 602, 30 S. W. 736; *Gogebie Inv. Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. 726, 23 Am. St. Rep. 417; *Thompson, Corporations*, secs. 3945, 3983; 2 *Morawetz, Corporations*, sec. 829.

¹³⁰ *Easton Nat. Bank v. American Brick & Tile Co.*, 70 N. J. Eq. 732, 64 Atl. 917, 8 L. R. A. (N. S.) 271, 10 Ann. Cas. 84; *J. W. Cooney Co. v. Arlington Hotel Co.*, 11 Del. Ch. 286, 101 Atl. 879, 890; *Dupont v. Ball*, 11 Del. Ch. 430, 106 Atl. 39, 7 A. L. R. 955; *Sprague v. National Bank of America*, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; *Gillett v. Chicago Title & Trust Co.*, 230 Ill. 373, 82 N. E. 891; *Rosoff v. Gilbert Transp. Co.*, 221 Fed. 972 (under Connecticut Statute).

owed to the corporation to contribute capital up to the par value of the shares, and does not accrue to the creditor directly upon a kind of tort liability in the nature of deceit.

Existing creditors, and creditors participating, consenting, or with knowledge.—As we have seen, the doctrine that persons who receive stock of a corporation under an agreement by which they are to pay nothing therefor, or to pay less than its par value, may be compelled to pay in full for the benefit of creditors of the corporation, is frequently placed upon the ground of fraud. It can be invoked, under this theory in favor of such creditors only as have dealt with the corporation on the faith of the stock being fully paid. Those who have not done so are not defrauded, and cannot complain. The idea is that the issue of fictitiously paid-up stock, is a fraud upon creditors who contract with the corporation in reliance upon its capital remaining intact, or in reliance upon the professed capital having been in fact paid up in full. It is only those creditors who can fairly allege that they have relied, or whom the law presumes to have relied, upon the amount of capital stock of the company, who have a right to make such inquiry as to the inadequacy of consideration for the stock and set aside a fictitious arrangement for its payment.¹³¹

It follows that an issue of watered or fictitiously paid-up stock by a corporation cannot be attacked, nor the holders thereof be compelled to pay its full par value, by or for the benefit of persons who dealt with the corporation and became creditors before the stock was issued.¹³² The same is true of a creditor who participated in the issue of the stock, or consented thereto, whether he partici-

¹³¹ First Nat. Bank of Deadwood v. Gustin Minerva Consol. Min. Co., 42 Minn. 327, 44 N. W. 198, 6 L. R. A. 676, 18 Am. St. Rep. 510.

The fraud theory is not based on a wrong done to any specific creditors, but is adopted as an explanation of imposing liability on those who receive watered stock and to enforce the duty to pay par for benefit of creditors. See 25 Columbia Law Rev. 408, 421. The creditors need not plead or prove actual reliance on the underpaid stock; want of possible reliance is a matter of defense to stockholders.

¹³² Handley v. Stutz, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530;

Coit v. North Carolina Gold Amalgamating Co., 14 Fed. 12, aff'd 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; First Nat. Bank of Deadwood v. Gustin Minerva Consol. Min. Co., 42 Minn. 327, 44 N. W. 198, 6 L. R. A. 676, 18 Am. St. Rep. 510; Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637; Stuart's Petition, 272 Fed. 938; Scott v. Barton, 285 Mo. 427, 226 S. W. 958.

Under a statute in Tennessee, all unpaid stock, whenever subscribed, is a trust fund for the payment of all corporate debts, whether created before or subsequent to the subscrip-

pated as a stockholder or officer of the corporation, or as its attorney, or otherwise.¹³³ And it is equally true of a creditor who dealt with the corporation with actual or constructive notice of the stock watering, as that the stock was issued in exchange for property at an intentional overvaluation.¹³⁴

§ 213. Statutory obligation theory.

The policy of the law is to require payment of the par value of the shares in cash or property. The courts might well base their requirement of full payment of the shares upon an inference from the statute and the privilege of limited liability. Unfortunately the courts have felt the necessity of rationalizing liability for watered stock upon forced and artificial theories from which unreasonable deductions have been made, as in the case of the now popular fraud or holding-out theory.

A statutory liability or obligation to pay the par value of stock is not affected by knowledge of the creditor. In Illinois a statute provides that "each stockholder shall be liable for the debts of the corporation to the extent of the amount that may be unpaid upon the stock held by him," and it has been held that the right of a creditor to compel a stockholder to pay the difference between the par value of his stock and what he has paid in money or property under his agreement with the company is not in any way affected by the fact that he knew, or did not know, when he extended credit to the company, that the stock was in part unpaid.¹³⁵

The New Jersey court has placed the stockholders' liability on watered stock neither on the "trust fund" nor the "holding out" theory, but upon the acceptance of a statutory method of limiting

tions. *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123, 28 S. W. 668, 26 L. R. A. 509, 45 Am. St. Rep. 700.

¹³³ *Bank of Fort Madison v. Alden*, 129 U. S. 372, 32 L. Ed. 725, 9 Sup. Ct. 332; *Coit v. North Carolina Gold Amalgamating Co.*, 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; *Nierosi v. Calera Land Co.*, 115 Ala. 429, 22 So. 147; *Ten Eyck v. Pontiac, O. & P. A. R. Co.*, 114 Mich. 494, 72 N. W. 362; *Callanan v. Windsor*, 78 Iowa 193, 42 N. W. 652.

¹³⁴ *Sherman v. Harley*, 178 Cal. 584, 174 Pac. 901, 7 A. L. R. 950; *Coit v. North Carolina Gold Amalgamating Co.*, 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; *Watt v. German*

Sav. Bank, 183 Iowa 346, 165 N. W. 897; *Scott v. Luehrmann*, 278 Mo. 638, 213 S. W. 855; *Baldwin v. Timber Inv. Co.*, 43 N. D. 638, 176 N. W. 662.

Creditor's knowledge that stock is unpaid or watered, as affecting stockholder's liability to pay par value, see *Du Pont v. Ball*, 11 Del. Ch. 430, 106 Atl. 39, 7 A. L. R. 955, 972n.

¹³⁵ *Sprague v. National Bank of America*, 172 Ill. 149, 168, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17, 32. See *Rosoff v. Gilbert Transp. Co.*, 221 Fed. 972; *Du Pont v. Ball*, 11 Del. Ch. 430, 106 Atl. 39, 7 A. L. R. 955.

liability, which may be had on condition of paying par value for the stock. The law requires stock subscriptions to be made good for the benefit of creditors of insolvent companies, without distinction between prior and subsequent creditors, or between creditors who had notice and those who had none.¹³⁶ In *Easton Nat. Bank v. American Brick & Tile Co.*,¹³⁷ it is held that under the New Jersey General Corporation Act of 1875, a creditor's knowledge that stock was improperly issued as "full paid" and as "issued for property purchased," when the fact was otherwise, is not sufficient to debar him from relief against recipients of the stock. As Pitney, J., points out, if the only foundation of the stockholders' liability to creditors is that of having held out the issued stock as a source from which payment might be expected, then it would not be irrational to debar from any claim creditors whose claims accrued prior to the stock issue in question, and subsequent creditors who had notice. But in New Jersey, stockholders' liability upon watered stock does not depend alone or chiefly upon the theory of fraud or "holding out." It depends upon the stockholders' statutory obligation that the stock subscription be made good for the benefit of creditors of insolvent companies. The obligation is owed by the holders of watered stock without distinction between prior and subsequent creditors, or between creditors who have had notice and those who had none. Watered stock, under whatever device, is absolutely alien to the statutory policy of the state, which prohibits that stock be issued without the receipt of an equivalent in value.

It is submitted that the constructive fraud doctrine, as laid down in the *Hospes* case and other cases adopting that theory, is no more sound or satisfactory as a basis for the stockholder's liability on watered stock than the trust fund doctrine. In the first place the stockholder, by accepting a certificate of watered stock, does not make any actual representation to the creditor that he has paid for the stock in full and it seems difficult to convict him

¹³⁶ *Easton Nat. Bank v. American Brick & Tile Co.*, 70 N. J. Eq. 732, 64 Atl. 917, 8 L. R. A. (N. S.) 271, 10 Ann. Cas. 84; *Dupont v. Ball*, 11 Del. Ch. 430, 106 Atl. 39, 7 A. L. R. 955. See 24 Columbia Law Rev. 772, 777; 25 Columbia Law Rev. 408; 34 Harvard Law Rev. 286. The legislature in requiring a par value im-

pliedly requires payment of that par value. That is its function.

¹³⁷ 70 N. J. Eq. 732, 739, 64 Atl. 917, 921, 10 Ann. Cas. 84, 8 L. R. A. (N. S.) 271. See *Volney v. Nixon*, 68 N. J. Eq. 605, 60 Atl. 189; *Holcombe v. Trenton White City Co.*, 80 N. J. Eq. 122, 82 Atl. 618; *Rosoff v. Gilbert Transp. Co.*, 221 Fed. 972 (Connecticut law).

of having participated in any.¹³⁸ As a general thing the creditor does not know how much of the authorized capital stock has been actually issued. Various writers on nonpar stock have clearly pointed out that as a business reality the amount of outstanding stock purporting to be fully paid up affects the question of corporate credit very little, if at all. The time has gone by, if it ever existed, when the creditor relied on the professed capitalization rather than upon the real financial condition in extending credit.¹³⁹

The fictitious basis of this fraud doctrine clearly appears when we find that the supposed reliance of the creditor is *presumed* and that public policy requires that the fact whether a particular creditor did or did not trust the corporation on that basis should not be inquired into.¹⁴⁰ It is apparent from this that the rule is really based upon reasons of convenience, public policy, and practical justice and that the supposed fraud is fraud in law or imaginary fraud rather than actual fraud. In other words, it is merely a name for something else.

The capital stock of a corporation is the basis of its credit, not because of actual reliance by creditors on the precise amount of stock issued, but because the contributions of the stockholders are the substitute for their personal liability. It is not any misrepresentation of fact as to the amount of paid-in capital which is the basis of liability, but the obligation imposed by law on the stockholder to contribute capital as an incident of membership in a limited liability corporation. This obligation is in the nature of an asset of the corporation and should be available to prior creditors and to subsequent creditors with notice as well as to those whose debts were contracted after the subscription without notice. The law assures to those dealing with the company, where the

¹³⁸ See Hunt, Trust Fund Theory, 12 Yale Law Journal 63. Compare 2 Morawetz, Corporations, sec. 781; Ballantine, 7 Minnesota Law Rev. 79: The idea that a certificate for paid-up shares is a representation to creditors that the full par value of the shares has been paid to the corporation is absurd. In the first place the creditor never sees the certificate, and in the second place the representation or statement is not made by the stockholder. See Downer v. Union Land Co., 113 Minn. 410, 129 N. W. 777; 9 California Law Rev. 61; 25 Harvard Law Rev. 278; 25 Columbia Law Rev. 408, 412.

¹³⁹ Bank v. Belington Coal & Coke Co., 51 W. Va. 60, 41 S. E. 390; State ex rel. Standard Tank Car Co. v. Sullivan, 282 Mo. 261, 221 S. W. 728; 1 Machen, Corporations, sec. 786; Rice & Harno, Shares with no par value, 5 Minnesota Law Rev. 494.

¹⁴⁰ Dwinnell v. Minneapolis Fire & Marine Ins. Co., 97 Minn. 340, 347, 106 N. W. 312; Randall Printing Co. v. Sanitas Mineral Water Co., 120 Minn. 268, 139 N. W. 606, 43 L. R. A. (N. S.) 706; R. H. Herron Co. v. Shaw, 165 Cal. 668, 133 Pac. 488, Ann. Cas. 1915 A 1265.

liability is limited, that the whole of the subscribed capital shall remain available for the discharge of its liabilities, except as diminished by losses and expenditures in the course of business. Capital may be lost in carrying on the business and the stockholder is not bound to replace it or keep it unimpaired except in banks and financial corporations; but he cannot properly escape his obligation to contribute capital by any fictitious arrangement with the corporation or by withdrawing his contribution to the prejudice of creditors. That is the meaning and significance of the par value placed upon shares of stock.

The true theory of stockholders' liability upon watered and bonus stock thus appears to be that of an obligation imposed either by statute or common law upon original subscribers and purchasers with notice to make a contribution to capital for the benefit of creditors as an incident of membership in the corporation.¹⁴¹ On this theory the stockholder becomes liable without the aid of any fiction of reliance by the creditor on the professed capital. It may be that in imposing such an obligation the courts have been doing legislative work but it is in line with the general policy of the law as to corporations. No one can justly expect to become a member of a corporation and share in the profits of the enterprise without taking some financial responsibility and contributing his share of the capital.¹⁴² The obligation is a positive one imposed by law; it is an asset of the corporation, in its true nature; and the release of this obligation without fair equivalent, while valid against the corporation, is in effect a fraudulent conveyance as against all creditors in event of subsequent insolvency, because it deprives the corporation of the prescribed basis of financial responsibility, which is demanded by the policy of the law as the price of limited liability. The duty to contribute being an asset of the corporation may be called a "trust fund" in the sense that the corporation cannot dispense with or release it as against creditors.

¹⁴¹ *Bottlers' Seal Co. v. Rainey*, 243 N. Y. 333, 153 N. E. 437 (statutory liability created to creditors even where no contractual liability to the corporation exists on stock not fully paid up); *Ballantine, Stockholder's Liability*, 7 Minnesota Law Rev. 79. See *Pepper*, 34 Amer. Law Reg. (N. S.) 448, 457, 459.

¹⁴² *Gordon v. Cummings*, 78 Wash. 515, 139 Pac. 489; *Holcombe v. Tren-*

ton White City Co., 80 N. J. Eq. 122, 82 Atl. 618.

The law says to the stockholder: "You are not entirely without responsibility for the debts of this enterprise. You must make a contribution of capital to the business to the par value of the stock issued to you as a burden incident to holding such stock, at least where needed to meet the claims of creditors." This is the

§ 214. Issue of additional stock by going concern.

The doctrine under which stockholders of a corporation are held liable to pay the full amount of their stock for the benefit of creditors, notwithstanding an agreement to the contrary with the corporation, is not limited to original capital stock, but applies also, subject to some limitations, to new stock issued by a corporation upon increasing its capital stock. If a corporation increases its capital stock for the mere purpose of adding to the original capital stock, and enabling it to do a larger and more profitable business, a subscriber for the new stock is in substantially the same position as a subscriber for the original stock, in so far as payment therefor is concerned. If the stock is issued as full-paid, upon payment or agreement to pay in part only, or gratuitously, and the corporation becomes insolvent, subsequent *bona fide* creditors may compel him to pay the balance, if necessary for the satisfaction of their claims, as shown in the preceding paragraphs.¹⁴³

It is a common practice for a corporation to issue additional stock from time to time as the company requires additional capital. But if the market price of the already issued stock has fallen below par, new stock cannot be sold except at a similar price. The corporation must issue the new stock at less than par, or else raise its capital by borrowing. In *Handley v. Stutz*,¹⁴⁴ the Supreme Court held that a corporation which was in need of funds in order to continue in business might issue its stock at the best available price without liability to creditors. By the weight of authority, there is no liability, in the absence of a statute, where an active corporation becomes embarrassed, and issues an increase of its capital stock in good faith at the best price that can be obtained, although it may be less than the par value, either in the payment of debts, or to raise money for the successful continuance of its business.¹⁴⁵

basis of limited liability, which is limited to the par value of the shares.

¹⁴³ *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530, rev'g 41 Fed. 531; *Flinn v. Bagley*, 7 Fed. 785.

¹⁴⁴ 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530. See also, *Clark v. Bever*, 139 U. S. 96, 35 L. Ed. 88, 11 Sup. Ct. 468 (corporation may settle with creditors by issue of stock at 20 cents on the dollar, without liability to assessment). It has been asserted that the court evidently intended that the release from liability should be

granted only in cases where the issue of stock at a discount was the last resort of a tottering concern. 25 Columbia Law Rev. 430. There seems slight risk that creditors will be misled, and on the other hand great possible advantage to them if new stockholders contribute much needed funds.

¹⁴⁵ *Clark v. Bever*, 139 U. S. 96, 35 L. Ed. 88, 11 Sup. Ct. 468; *Fogg v. Blair*, 139 U. S. 118, 35 L. Ed. 104, 11 Sup. Ct. 476; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; *Thoms & Brenneman v. Goodman*, 254 Fed. 39; *Courtney v. Georg-*

This same rule is applied where it issues such stock in good faith as a bonus in order to induce persons to purchase its bonds at their par value.¹⁴⁶ The transaction must be in good faith, and not a mere device for recklessly or fraudulently disposing of the stock to the prejudice of stockholders or creditors.¹⁴⁷

Treasury stock.—It is too clear to admit of question, that, when stock has been once issued and fully paid for, there is nothing to prevent the stockholders from donating the whole or a part thereof to the corporation, or to a trustee for its use, to be disposed of for its benefit; and in such a case the corporation or trustee may dispose of the stock at less than its par value without violating statutory or constitutional provisions regulating the issue of stock, and without rendering purchasers thereof liable to creditors beyond the price which they agree to pay.¹⁴⁸ This exception to the general doctrine does not apply, however, where the transaction under which the corporation reacquires the shares is not in good faith, but a mere device on the part of the stockholders to avoid payment in full. Stockholders cannot escape liability to creditors by subscribing for stock, and then surrendering it to the corporation before payment therefor, and afterwards taking the same from the corporation, controlled by them, at a reduced value.¹⁴⁹ Treasury shares upon strict analysis represent the power to create shares in place of shares which have been issued but which have been retired by purchase or forfeiture or donation to the corporation for the purpose of reissue. Such shares may be issued at less than par value, provided that as a result of the original issue and the reissue the corporation receives a total consideration equal to their par value.

er, 228 Fed. 859; *J. F. Lucey Co. v. McMullen*, 178 Cal. 425, 173 Pac. 1000; *Dummer v. Smedley*, 110 Mich. 466, 68 N. W. 260, 38 L. R. A. 490. Contra, *Jackson v. Traer*, 64 Iowa 469, 20 N. W. 764, 52 Am. Rep. 449. See 3 *Minnesota Law Rev.* 281; *Wickersham*, 22 *Harvard Law Rev.* 319, 331; 25 *Amer. Law. Rev.* 749, 940; 39 *Amer. Law Reg. (N. S.)* 175.

¹⁴⁶ *Fogg v. Blair*, 139 U. S. 118, 35 L. Ed. 104, 11 Sup. Ct. 476; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; *Dummer v. Smedley*, 110 Mich. 466, 68 N. W. 260, 38 L. R. A. 490.

¹⁴⁷ *Fogg v. Blair*, 139 U. S. 118, 35 L. Ed. 104, 11 Sup. Ct. 476. See *New Castle N. W. Ry. Co. v. Simpson*, 21 Fed. 533.

¹⁴⁸ *Davis v. Montgomery Furnace & Chemical Co.*, 101 Ala. 127, 8 So. 496; *Lake Superior Iron Co. v. Drexel*, 90 N. Y. 87; *Osage Oil & Refining Co. v. Haller*, 280 Fed. 693; *Lone Star Life Ins. Co. v. Shield* (Tex. Comm. App.), 228 S. W. 196. See 11 *Minnesota Law Rev.* 167.

¹⁴⁹ *Alling v. Wenzel*, 133 Ill. 264, 24 N. E. 551. See also, *Belknap v. Adams*, 49 La. Ann. 1350, 22 So. 382; *Sherman v. S. K. D. Oil Co.*, 185 Cal. 534, 197 Pac. 799; *Butterworth v.*

§ 215. Liability after transfer of stock.

There are various obstacles in the way of recovery by creditors against holders of watered stock. In the first place there is serious difficulty in proving deliberate or fraudulent overvaluation when stock is issued for property or services. Innocent transferees in general are not liable. All stockholders who have bought their stock in the open market supposing it to have been paid up in full take free and clear. In most states prior creditors and creditors with notice of the manner of payment may not complain.¹⁵⁰

Whether there is any liability on the part of the transferee of watered stock generally is made to depend upon whether he was a *bona fide* purchaser. If he purchased with notice, actual or constructive, that the stock was not in fact fully paid up, he is subject to the same liability as his transferrer; but he is not liable at all if he purchased without such notice.¹⁵¹ As the California court points out, watered stock purports to be fully paid and the transferee cannot be held to assume any obligation to the corporation to pay further calls on capital account. "What then, is the principle upon which the holder of watered stock is, under any circumstances, held obligated to supply substance instead of water, to make good what it is pretended that corporation received but did not? . . . He is liable only because of the original transaction whereby the stock was issued for a fictitious consideration and then only to those who were defrauded thereby. . . . Upon the plainest principles, therefore, he cannot be held liable unless he was either a party to the transaction in the first instance or has in effect in some manner made himself a party since."¹⁵²

The holder of watered or fictitiously paid-up stock cannot escape liability to creditors by transferring the same to an irresponsible

Ross, 238 Mass. 279, 130 N. E. 678; In re Pipe Line Oil Co., 289 Fed. 698.

¹⁵⁰ Shareholder's defenses against liability to creditors on watered stock, J. C. Bonbright, 25 Columbia Law Rev. 408, 418, 432.

¹⁵¹ A good faith purchaser of stock issued as fully paid is not liable to corporate creditors for any unpaid balance or water. Rhode v. Dock-Hop Co., 184 Cal. 367, 194 Pac. 11, 12 A. L. R. 437; Lavell v. Bullock, 43 N. D. 135, 174 N. W. 764; Higgins v. Illinois Trust & Savings Bank, 193 Ill. 394, 61 N. E. 1024; Davies v.

Ball, 64 Wash. 292, 116 Pac. 833, Ann. Cas. 1914 B 750, 755; Brant v. Ehlen, 59 Md. 1; 6 Fletcher, Corporations, sec. 3771; 7 R. C. L., sec. 389. But see Shugart v. Maytag, 188 Iowa 916, 176 N. W. 886; 24 Columbia Law Rev. 774; 40 Harvard Law Rev. 779.

¹⁵² Rhode v. Dock-Hop Co., 184 Cal. 367, 194 Pac. 11, 12 A. L. R. 437. See 9 California Law Rev. 238. It would seem to be implied that the transferor would still be liable. On the fraud theory, can a transferee with notice be held on bonus or underpaid stock to a creditor who be-

person or to a *bona fide* purchaser, and in some states he remains liable under all circumstances.¹⁵³

§ 216. Remedies of creditors.

The liability of stockholders on bonus and watered stock is ordinarily to be enforced in equity by creditors' bill, after judgment and execution returned unsatisfied. The creditor must first exhaust his remedies against the corporation.¹⁵⁴ In some jurisdictions all persons interested as creditors and stockholders may be joined and their rights and liabilities determined in one proceeding. Whether the liability on watered stock is a corporate asset which passes to the corporation's trustee in bankruptcy, or whether it belongs to creditors only depends on the law of the state of incorporation.

In *Harrigan v. Bergdoll*,¹⁵⁵ Brandeis, J., says: "The nature, the extent, and the conditions of the liability of a stockholder on account of stock not full-paid depend primarily upon the law of the state or country by which the corporation was created. That law determines whether the liability is to the corporation or is to creditors. If the liability is to the corporation, it passes like other choses in action to the trustee in bankruptcy. The Bankruptcy Law (Comp. St. §§ 9585-9656) does not modify the right of action against the stockholder or create a new one. It merely provides that the right created by the state law shall pass to the trustee and be enforced by him for the benefit of creditors. The order of assessment and the direction that the trustee sue to recover were appropriate administrative proceedings in bankruptcy. See *In re Miller Electrical Maintenance Co. (D. C.)* 111 Fed. 515. But it was for the court of Pennsylvania to say whether they were indispensable to the enforcement of the stockholder's liability."

came such after the issue of the stock, but before the transfer?

¹⁵³ *Wishard v. Hansen*, 99 Iowa 307, 68 N. W. 691, 61 Am. St. Rep. 238; *Sprague v. National Bank of America*, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17. See *Moore v. Moffatt*, 188 Cal. 1, 204 Pac. 220; *Palmer v. Scheftel*, 194 N. Y. App. Div. 682, 186 N. Y. Supp. 84.

That both transferor and also the transferee with notice are liable on watered stock, see *Wolcott v. Waldstein*, 86 N. J. Eq. 63, 97 Atl. 951. That transferor remains liable on the ground that his transferee without

notice would escape liability, see *Palmer v. Scheftel*, 194 N. Y. App. Div. 682, 186 N. Y. Supp. 84.

¹⁵⁴ *Sherman v. S. K. D. Oil Co.*, 185 Cal. 534, 197 Pac. 799; *Scott v. Barton*, 285 Mo. 427, 226 S. W. 953.

¹⁵⁵ 270 U. S. 560, 70 L. Ed. 733, 46 Sup. Ct. 413. See *In re Jassoy Co.*, 178 Fed. 515; *Babbitt v. Read*, 215 Fed. 395, aff'd 236 Fed. 42, 49, 50; *Courtney v. Georger*, 228 Fed. 859; *Courtney v. Croxton*, 239 Fed. 247; *In re Stuart's Petition*, 272 Fed. 938; *In re Pipe Line Oil Co.*, 289 Fed. 698; *Johnson v. Tennessee Oil Co.*, 74 N. J. Eq. 32, 69 Atl. 788, 791.

In some states the liability of stockholders on watered stock is held to exist in favor of the corporation so that the trustee succeeds to the claim and may enforce it for the benefit of the creditors. Under the prevalent doctrine that the stockholders' liability for watered and bonus stock is based upon fraudulent representations and that only subsequent creditors who rely upon the representation can recover, the trustee in bankruptcy of the corporation, as successor to the property of the bankrupt, is not the proper person to sue the stockholders. The liability is not an asset of the corporation and does not pass to the trustee, and the Bankruptcy Act does not give the trustee the right to sue as a representative of the creditors.¹⁵⁶ The claim of the creditors is supposed to rest in tort for fraudulently representing that the capital stock was paid up in full when it was not, and the wrong is one done directly to the creditors. As pointed out by Justice Dibell in the *Kenny* case, the result is unfortunate as the bankruptcy court ought to be able to wind up the whole matter. As Justice Dibell says: "A holding which would permit the bankruptcy court in its administration of the bankrupt estate to enforce through its trustee the liability of holders of bonus stock, or to decline to do so and leave it to the state courts, as the convenience of the particular estate suggests," would be more workable. To allow the trustee in bankruptcy to sue stockholders liable on watered stock would have great practical advantages. It would "obviate numerous suits by individual creditors, many perhaps for small amounts; would allow all creditors to share *pro rata*; and would prevent any being precluded by the expense of individual suits, or by lack of diligence. Likewise, the burden on the shareholders would be distributed more evenly; for assessments would be levied *pro rata* on all stockholders."¹⁵⁷

Statute of limitations on bonus or watered stock.—The statute of limitations does not begin to run against a suit by creditors of a corporation to compel payment by holders of bonus or watered

¹⁵⁶ *State Bank of Commerce v. Kenney Band Instrument Co.*, 143 Minn. 236, 173 N. W. 560; *Selig v. Hamilton* 234 U. S. 652, 58 L. Ed. 1518, 34 Sup. Ct. 926, Ann. Cas. 1917 A 104; *Courtney v. Croxton*, 239 Fed. 247; *Courtney v. Georger*, 228 Fed. 859; *In re Associated Oil Co.*, 289 Fed. 693. See *contra*, *Du Pont*

v. Ball, 11 Del. Ch. 430, 106 Atl. 39, 7 A. L. R. 955; *In re Pipe Line Oil Co.*, 289 Fed. 698; *Babbitt v. Read*, 215 Fed. 395, *aff'd* 236 Fed. 42. See also, *ante*, § 201, note 48.

¹⁵⁷ The right of the trustee to recover the amount unpaid on capital stock, 24 Columbia Law Rev. 772, 774.

stock before the insolvency of the corporation,¹⁵⁸ and it may not commence to run even then. It has been held that, when a corporation issues stock at less than its par value, and the agreement not to require further payment is binding as between it and the stockholders, but void against subsequent *bona fide* creditors, as elsewhere explained,¹⁵⁹ the statute of limitations does not commence to run against the right of creditors to compel full payment by the stockholders until such right accrues, and the right does not accrue until it becomes necessary to enforce payment for the satisfaction of their debts, and therefore that the statute does not run against an action by a creditor until insolvency or perhaps not even then until he has exhausted his legal remedies against the insolvent concern. According to some courts the right of a trustee in bankruptcy or receiver, if he has the right to enforce this liability, runs from the time of demand or its equivalent, *i. e.*, order of court.¹⁶⁰

C. NONPAR STOCK.

§ 217. Use and abuse of nonpar stock.

In the last few years, thirty-nine of the states and the Dominion of Canada have adopted laws under which corporations may be formed with stock having no stated par value.¹⁶¹ The great beauty

¹⁵⁸ *Hospes v. Northwestern Mfg. & Car Co.*, 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637; *Jones v. Whitworth*, 94 Tenn. 602, 30 S. W. 736; *Vaughn v. Alabama Nat. Bank*, 143 Ala. 572, 42 So. 64, 5 Ann. Cas. 665.

¹⁵⁹ *Ante*, § 208 et seq.

Spencer v. Anderson, 193 Cal. 1, 222 Pac. 355, 35 A. L. R. 822. The claim of a judgment creditor of a corporation against the recipient of bonus or watered stock arises although the corporation itself had no cause of action.

¹⁶⁰ *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *In re Phoenix Hardware Co.*, 249 Fed. 410; *Courtney v. Youngs*, 202 Mich. 384, 168 N. W. 441; *Kaye v. Metz*, 186 Cal. 42, 198 Pac. 1047; *Butterworth v. Ross*, 238 Mass. 279, 130 N. E. 678. See 35 A. L. R. 840n.

¹⁶¹ The most valuable material so far is found in periodicals. The following articles deal in whole or in

part with the subject of nonpar stock: Allen, *Nonpar stock*, 90 Cent. Law Journal 170; Ballantine, *Nonpar stock—its use and abuse*, 57 Amer. Law Rev. 233; Ballantine, *Stockholders' Liability in Minnesota*, 7 Minnesota Law Rev. 79; Berle, *Problems of nonpar stock*, 25 Columbia Law Rev. 43; Bonbright, *Dangers of nonpar shares*, 24 Columbia Law Rev. 449, 59 Amer. Law Rev. 502; Bronaugh, *Corporate shares without par value*, 26 Law Notes 87; Clay, *Shares without par value*, 13 Kentucky Law Journal 275; Colton, *Par value versus no-par value stock*, 7 Amer. Bar Ass'n Journal 671; Harno & Rice, *Nonpar value stock*, 5 Minnesota Law Rev. 493, 56 Amer. Law Rev. 821, 3 Illinois Law Bul. 71; Hollen & Tut-hill, *Uses of stock having no par value*, 7 Amer. Bar Ass'n Journal 579; Mitchell, *Capitalization of corporations issuing shares without par value*, 11 Amer. Bar Ass'n Journal 377; Morawetz, *Shares without par*

of nonpar stock is that the holder of the shares is not liable to creditors beyond the price fixed by the corporation. This renders inapplicable the great mass of law as to stockholder's liability on bonus and watered stock. Stock without par value can be issued as fully paid for contracts, patents, mines or promotion services. It furnishes a very convenient means of providing liberally for those who have promoted the corporation. New York led the way in authorizing shares without par value in 1912. The new device has been enthusiastically received, but the possible abuses of nonpar stock which are coming to light indicate certain fundamental points which need more attention than most of the present laws have given.

The vital difference between par value and nonpar stock lies in the method of fixing the consideration or contribution to be made by the subscriber to the capital of the corporation.¹⁶² In par value stock the subscriber is required to contribute a fixed amount and the corporation cannot fix a different consideration as against creditors. It is the giving up of the attempt to require the contribution of this fixed amount which is the feature which has served to induce those interested in corporate organization to advocate and adopt the idea of stock without par value. The statutes provide that when the full consideration agreed has been paid or delivered, the stock shall be deemed full paid and shall not be liable for any further call or assessment.

value, 26 Harvard Law Rev. 729; Pierson, Stock having no par value, 17 Illinois Law Rev. 173; Rogers, Stamp tax on shares of no par value, 95 Cent. Law Journal 448; Shaffer, Organization of companies under the Nonpar Value Stock Act, 55 Amer. Law Rev. 438; Warren, Protection of creditors, 36 Harvard Law Rev. 501; Wickersham, Progress of the law on no par value stock, 37 Harvard Law Rev. 464; Wickersham, The capital of a corporation, 22 Harvard Law Rev. 319; Wickersham, Taxation of no par value stock, 39 Harvard Law Rev. 289.

For an adverse criticism upon nonpar stock, see Cook, Stock without par value, 19 Michigan Law Rev. 583, 7 Amer. Bar Ass'n Journal 534.

¹⁶² Roberts & Schaefer Co. v. Emmerson, 271 U. S. 50, 70 L. Ed. 827, 46 Sup. Ct. 375.

The more important differences be-

tween the two classes of stock appear in the Illinois case of Roberts & Schaefer Co. v. Emmerson, 313 Ill. 137, 144 N. E. 818: "Par value stock may be issued only for money or property equivalent to the par value. No par value stock (under the Illinois statute) may be issued for money or property of any amount or value provided it is not less than \$5 or more than \$100 per share. From this it follows that all the par value stock of an authorized class must be issued, if issued at all, at a uniform value or price, while nonpar value stock may be issued from time to time at different prices or values, although the holders of all these shares are entitled to share equally in the distribution of profits of the corporation. The liability of stockholders of the two classes of stock for the debts of the corporation may be different."

One of the principal arguments advanced in favor of nonpar stock is that par value stock is misleading to investors. We are asked to believe that the recent enthusiasm for nonpar stock is due to a philanthropic desire on the part of promoters that their issues of stock shall not be deceptive to would-be investors. Some writers and courts seem to labor under the delusion that it is the doctrine of the law as to par-value stock that the assets or capital of the corporation shall at all times equal the face value of the stock and that theoretically the par value of the stock is an index to the financial condition.¹⁶³ Such, however, is only the case with banks and financial corporations. Shares of designated par value represent membership rights or interests based on specified sums of money supposedly contributed, or to be contributed, to the capital. But there is no obligation to restore this capital if it once becomes impaired in the course of business. The par value of issued stock is not supposed to be an index of the financial condition for the information of investors and creditors and is probably not usually relied upon as such. The argument that nonpar stock will focus the attention of the investor on the real values back of the shares carries little weight.¹⁶⁴ A more substantial argument is that some method should be provided to give founders and organizers an interest in the corporation and its profits, regardless of the actual contribution in money or property which they make to the corporate capital.

¹⁶³ "Par value except as a unit of stockholder's interest is nothing but a theory useless to the business creditor or investor, but a strong trump card in the hands of the fly-by-night dishonest stock promoter to fool the uneducated bargain hunter who is without means independently to check values and is, as a consequence quite customarily misled by the dollar mark appearing on the face of a beautifully engraved but otherwise quite worthless stock certificate." F. B. Odum, Reports Amer. Bar Ass'n 1925, vol. 50, p. 823. For Bibliography, see same volume, p. 834. Compare 50 Amer. Bar Ass'n Rep., pp. 839, 849.

See Commercial Credit Co. v. Tait, 2 Fed. (2d) 862. Stock having par value is supposed to represent rights based on the payment or transfer to the corporation of capital equal to

the sum stated as the par value. The issue of nonpar stock involves no representation as to the value received by the corporation. It is, however, not correct to say that the real purpose of nonpar stock is that it shall be accepted at its actual value rather than at an alleged value appearing on its face, but rather to escape from some of the liabilities of par value stock and restrictions thereon.

¹⁶⁴ It is common on recapitalization or change from par to nonpar to give holders of the old par value stock several shares of nonpar for each share of par value stock. Often the increased number of shares will acquire a greater total market price than the same proportionate interest represented by the certificate for par value shares. See Hood Rubber Co. v. Commonwealth, 238 Mass. 369, 131 N. E. 201.

It is desirable that a going concern should be able to increase its capital by a new issue of stock, to be sold at the market price, rather than to be driven to an issue of bonds or notes after the stock has fallen below par. In order to float a new issue of stock it may be necessary to offer it at a considerable concession from the price of previous issues. Bonds and notes may be sold at a discount, and it should likewise be possible for a corporation to issue stock at the market price. It would also sometimes be desirable to offer a bonus of common stock with bonds or preferred stock to add a speculative attraction to the investment. Sufficient shares without par value may be issued full paid for a nominal consideration to be used as a bonus.

It is pointed out that theoretically the amount of a corporation's original capital has been fixed by the par amount of the shares issued by the corporation. But owing to the common practice of issuing paid-up shares in consideration of property taken at a valuation much in excess of its money or market value, the par value of shares issued rarely indicates or measures the amount actually contributed by its shareholders to capital. Some nonpar stock laws require a minimum capital to be stated in the certificate of incorporation and impose liability on the directors who create debts before receiving it. The amount of capital which a corporation must have as a basis of financial responsibility may be fixed without reference to the number or par value of shares issued, by an amount to be stated in the charter or articles of incorporation. The present nonpar stock laws, however, seem very inadequate in this respect.

There are two types of nonpar stock laws, in one of which the law does not require any specified amount of capital to be stated in the certificate of incorporation and contains no provision making directors liable for debts until a designated amount of capital has been paid in. This would seem to be the commonest type at the present time. The other type requires that the certificate shall set forth an amount of capital with which the corporation shall start and carry on business, usually equal to \$5 for each share authorized, and makes the directors personally liable for debts of the corporation until this amount has been paid in in cash or property.¹⁶⁵

¹⁶⁵ A. A. Berle, Jr., Problems of nonpar stock, 25 Columbia Law Rev. 43, 46: "Many states require the incorporators to certify that a given

amount of capital has been paid in at the commencement of corporate life—thus requiring a minimum paid-in capital fund (Wash. Comp. Stat.

In New York the Stock Corporation Law, secs. 12, 36, provides in relation to corporations having shares of capital stock without nominal or par value, that either one of the following statements must be included in the certificate of incorporation:

A. "The capital of the corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value, plus dollars (the blank space being filled in with some number representing one dollar or more) in respect to every issued share without par value, plus such amounts as, from time to time, by resolution of the board of directors, may be transferred thereto"; or

B. "The capital of the corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value, plus the aggregate amount of consideration received by the corporation for the issuance of shares without par value, plus such amounts as, from time to time, by resolution of the board of directors, may be transferred thereto."

There may also be included an additional statement that the capital shall not be less than dollars (the blank space being filled in with a number).

There is no provision in the law making directors liable for debts until a designated amount of capital has been paid in.

In Illinois the statement of incorporation must set forth the amount of stock which it is proposed to issue at once (which shall not be less than \$1,000, all of which must be subscribed), and the payment of at least one-half of the capital stock which it is proposed to issue at once, with a description of the nature and value of property, if any, paid for such capital stock. Directors are liable for all debts in excess of the amount of the capital of the corporation.

It is sometimes claimed that nonpar laws are intended to prevent stock watering but this is apparently often accomplished by giving up the attempt to prescribe any stated capital stock to be watered. Nonpar stock gives the holder the same rights and privileges as bonus and watered stock although it frees him from the burdens and disadvantages of possible liability to creditors. The

[Rem. 1922] sec. 3805, amended laws 1923, ch. 168, sec. 1; Cal. Laws 1923, ch. 293). Others, like New York, merely enact that the consideration received on sale of the nonpar shares shall be considered as capital."

Under some statutes, there must be

at least a minimum required amount, as for instance \$1 or \$5 paid on each share, and in Illinois it is also required that the amount actually received by the corporation for the stock be stamped on the certificate (Ill. Rev. Stat. 1921, ch. 32, sec. 30.)

public is not deceived by the fictitious and misleading dollar mark; the promoters escape liability; and the creditor and investor are put on inquiry. All they need to do is to ascertain what the company's actual net assets are and then they can estimate for themselves its financial responsibility. No easy task!

The possible abuses of nonpar stock indicate that there are certain points which need more careful attention than the present laws give, among which may be mentioned the ease of inflation and the danger of manipulation by issuing large amounts of stock for property of little value.¹⁶⁶ The protection given under "Blue Sky" laws is usually inadequate. The promoters may thus furnish the brains and the skill, while the public furnishes the cash to finance the enterprise and takes the risk for a minor share of the profits. Nonpar stock is very desirable to organizers to distribute, limit or arrange voting power and control.

One of the most serious objections to nonpar stock is the lack of sufficient basis of responsibility to creditors. Incorporation laws enable business men to organize and do business as a corporation without being subject to the liability of general partners. The corporate capital takes the place of the individual liability of the stockholder. The nonpar laws recognize the principle that no corporation should declare or pay any dividend out of capital, but many of these laws entirely overlook the necessity of providing a proper corporate fund for the payment of corporate debts as a condition to the right to do business as a corporation. The legal effect is to throw all the risks and hazards of the business upon the public who deal with the corporation, while the organizers and stockholders are to reap all possible gains, and lose little or nothing if the enterprise proves a failure.

What are the liabilities to creditors, if any, of purchasers of nonpar stock on the original issue? In general the subscriber will be liable to pay up the price agreed in the subscription agreement.¹⁶⁷ But if the consideration to be paid for such nonpar shares

¹⁶⁶ Cook, 19 Michigan Law Rev. 583, 592; 7 Amer. Bar Ass'n Journal 534; Shaffer, 50 Amer. Law Rev. 438; Pierson, 17 Illinois Law Rev. 173, 184.

¹⁶⁷ American Refining Co. v. Staples, — Tex. Civ. App. —, 260 S. W. 614, 617. The general rules of law regarding liability of subscribers for nonpayment of the full amount of

their subscriptions, and regarding the declaration of dividends only from the profits or surplus of the corporation, apply to no par value the same as to par value stock corporations. The liability depends on whether he has paid or delivered to the corporation the amount either in money or its equivalent for which the stock was sold.

is fixed by the certificate of incorporation, the subscriber will be liable up to this amount, even though his agreement with the corporation calls for a less amount. That creditors may not be as fully protected under no par value stock as they are where stockholders are under an obligation to pay for stock up to a stated par value is shown in a recent federal case.¹⁶⁸ Upon reorganization of a steel company 750 shares were given away and 2,250 shares of no par value common stock were divided between the promoters of the new corporation, organized under the General Corporation Law of Delaware, in consideration of a worthless option. The new company was adjudged bankrupt and the trustee in bankruptcy sued the holders of the no par value stock, as it had not been paid for. It was held that the owners of the stock were not liable. Even if the consideration was extra-legal, the court said: "The general if not universally accepted theory of the purpose of such (nonpar stock) statutes is that they are intended to do away with both the 'trust fund' and 'holding out' doctrines." It has been suggested, however, that in the case of stated value nonpar stock and to some extent in the case of corporations requiring a minimum fixed capital attributable to nonpar stock, there is some basis for each of these theories to be applied.¹⁶⁹

If "stock watering" is made to include any credit entry to capital stock account in excess of the actual contribution of the subscriber, in that event even no par stock may be watered. The over-valuation of assets is still open to the unscrupulous promoter. It has been suggested that there should be explicit requirements that when shares without par value are issued for property or services, the value of the consideration for which they are issued should be agreed upon as between subscriber and corporation, which value should appear in the financial reports. Provision could also be made for holding the stockholder liable as on part paid stock when the consideration turns out to have been fraudulently over-valued.¹⁷⁰

¹⁶⁸ *Johnson v. Louisville Trust Co.*, 293 Fed. 857, 36 A. L. R. 785. As to 750 shares of nonpar stock, no consideration was fixed by the board of directors and that stock was simply thrown in with other securities to give those organizing the corporation the right to share in the net earnings and in case of dissolution in the net assets in the proportions represented by the nonpar stock given them. See comment on case in 22 *Michigan Law*

Rev. 840, citing *Cook*, 19 *Michigan Law Rev.* 583; 7 *Amer. Bar Ass'n Journal* 534. See also, *Ballantine*, 57 *Amer. Law Rev.* 233; *Berle*, 25 *Columbia Law Rev.* 55, 56.

¹⁶⁹ *Berle*, 25 *Columbia Law Rev.* 55, 56; *Wickersham*, *Stock Without Par Value*, 83, 127.

¹⁷⁰ "It is perfectly simple to inflate the assets of a corporation with nonpar stock and to have the inflation reflect in the books an entirely erroneous

There is a possibility of fraud on subscribers and investors by diluting the stock already issued by subsequent issues at lower prices, or by diluting future issues by an original issue without consideration. Theoretically the subscriber should have some assurance that others will not pay less than he is required to pay. Under nonpar laws subsequent issues may be made either at a lower or higher price to secure the actual capital for the enterprise. The consideration for the shares is fixed by the directors, and control by the promoters can readily be secured by the issue of say 51 per cent of the stock at a nominal price in property. Subsequent issues may be made at a higher price in cash, thus enabling the organizers to appropriate to their benefit the capital contribution of these subsequent purchasers who really finance the enterprise.¹⁷¹

What rights have holders of nonpar stock against the corporation and its directors upon the issue of new shares? Mr. Berle states that they "have a right that new nonpar stock shall be issued only for (a) not less than the stated value of such stock as fixed by the certificate of incorporation, or (b) not less than a price agreed upon in advance and embodied in the certificate of incorporation, or (c) in the absence of such stated value or such agreed price, a price fixed by corporate action in a manner prescribed; but in this case, courts of equity will intervene to protect such stockholders against a new issue at an unreasonably low price."¹⁷²

ous declaration of value of the nonpar shares." T. A. Browne, 50 Amer. Bar Ass'n Rep. 836, 844.

Bonbright, Dangers of shares without par value, 24 Columbia Law Rev. 449, 465, 468. Directors make representations as to the value of assets received for stock in setting up the balance sheet, and promoters may perform the customary frauds of overvaluation while escaping from the possible liabilities incurred when par value stock is so issued. See also, Berle, 25 Columbia Law Rev. 56.

Where no-par value stock is issued for property turned in to the corporation two situations may arise: (1) the property may be set upon the asset side of the balance sheet at its actual value, and no-par shares issued in payment for it, or (2) the property may be set up on the asset side of the balance sheet at an inflated valuation. In this second situation the cor-

poration should have a right of recovery, for there is concealment of the real facts from the innocent purchasers of stock. See *Piggly Wiggly of Delaware v. Bartlett*, 97 N. J. Eq. 469, 129 Atl. 413, 418, 26 Columbia Law Rev. 452.

¹⁷¹ See 39 Harvard Law Rev. 682.

¹⁷² 25 Columbia Law Rev. 43, 56; 36 Yale Law Journal, 649, 656.

Atlantic Refining Co. v. Hodgman, 13 Fed. (2d) 781, 788: "It will thus be seen that, while an arbitrary sale of the same issue of stock at different prices to different persons would not be sanctioned, such differential sales will be sustained, if based on business and commercial facts which, in the exercise of fair business judgment, lead directors to follow such a course." Citing *Bodell v. General Gas & Elec. Corp.*, — Del. Ch. —, 132 Atl. 442.

As is pointed out in *Bodell v. General Gas & Electric Corporation*,¹⁷³ by the Delaware court. "Not more than 100 shares of stock having a par value of \$100 can be issued for \$10,000 worth of consideration. But for the same amount of consideration any number of no-par value shares may be issued. So far as the amount of consideration is concerned it may be run out to an infinitesimal sum under each no par share. . . . If the corporation has just been formed, I do not see that it can make any difference how much or how little in the way of consideration is received for its original no par stock, so long as it is lawful as to its quality."

"But suppose the corporation has been in business for some time and has built up a surplus above the assets originally received, then it is apparent that the price at which additional stock is issued does have a very material effect upon the interests of the existing shareholders." This proportionate interest in the assets and voting power is an equity which is entitled to protection against abuse of discretion by the directors in offering to others a share in assets belonging to existing shareholders without fairly paying therefor.

"Notwithstanding, therefore the absolute terms in which the power of the directors of this corporation to fix the price at which its unissued stock may be sold is expressed, equity will nevertheless by analogy to that reasoning which underlies the doctrine of preemptive right interfere to protect existing stockholders from an unjustified impairment of the values underlying their present holdings, where it is proposed by the directors to fix the consideration for new shares of the no par value type. Take the glaring case put a moment ago of a proposed sale by directors of stock for ten dollars a share which is demonstrably worth \$300 a share." ¹⁷⁴

¹⁷³ — Del. Ch. —, 132 Atl. 442, 446.

¹⁷⁴ *Bodell v. General Gas & Electric Corp.*, — Del. Ch. —, 132 Atl. 442. See also, Berle, 39 Harvard Law Rev. 679. Equity will not permit directors to discriminate and issue one block of stock at a high price and another block for next to nothing, and thus divide the contribution of the real investors among holders of the non-contributing shares. It is the duty of the directors to exact equal con-

tributions particularly as between shares of the same class issued at substantially the same time.

Atlantic Refining Co. v. Hodgman, 13 Fed. (2d) 781, reversing decree for plaintiff, 300 Fed. 590. See also *s. c.*, 2 Fed. (2d) 893; 8 Fed. (2d) 777. Sales of corporate stock at different prices are valid under Delaware law, if made for adequate reasons. Arbitrary sale of same issue at different prices will not be sanctioned.

Capitalization in case of nonpar stock.—The corporate capital takes the place of the individual liability of the stockholder. The nonpar laws recognize the principle that no corporation should declare or pay any dividend out of capital but many of these laws entirely overlook the necessity of providing a proper corporate fund for the payment of corporate debts as a condition to the right to do business as a corporation. What is the capital and what is the surplus of a corporation having stock of no-par value? Mr. Berle puts this concrete case.¹⁷⁵ The X corporation having a capital of \$1,000,000 and a surplus of \$500,000 against which there are issued ten thousand shares having a par value of \$100 each, reorganizes by conveying all its assets to a new corporation having ten thousand shares of nonpar value stock. Before reorganization the clear half million dollars surplus is available for dividends. There is danger upon reorganization and change to nonpar shares, that these will fix all assets transferred as consideration for such shares, freezing the previous surplus into capital account. It is important to preserve the free surplus, and therefore a clause should be inserted saving the surplus from capitalization. It would seem that the total consideration received for true nonpar stock must be attributed to capital, unless part of the consideration is expressly paid in as surplus. The statutory minimum of \$500 or \$1,000 is not presumably the measure of the contributions which are devoted to the corporate business and which cannot be impaired by dividends or otherwise withdrawn. The fund so dedicated to capital purposes is subject to the same "trust fund" safeguards as is a capital fund raised by shares having a par value.

Nonpar statutes should define what part of the proceeds of sale of stock shall be devoted to capital which cannot be distributed as dividends. If a large part of the consideration received for nonpar stock can be credited to paid in surplus, this opens the way to fraud upon creditors by reduction of the so-called "trust fund"; also to fraud upon stockholders through sale of new stock at lower prices and distribution of the proceeds among all the stockholders *pro rata*. Publicity should be given to the value at which property received for nonpar issues is entered on the books, for otherwise the capital account may be inflated and fictitious.

It is pointed out by Mr. Mitchell¹⁷⁶ that the statutes of the various states authorizing stock without par value may be roughly

¹⁷⁵ Berle, Problems of nonpar stock, 25 Columbia Law Rev. 43, 49.

¹⁷⁶ W. D. Mitchell, Capitalization

of corporations issuing shares without par value, 11 Amer. Bar Ass'n Journal 377.

classified as to the question whether any part of the consideration paid for the stock may be treated as paid in surplus available for dividends as follows:

(1) "Those that require a fixed or stated amount of capital and allow that part of the consideration received for the no par shares in excess of the stated capital to be treated as paid in surplus available for dividends."

(2) "Those which provide that the entire consideration received by the corporation for its no-par shares must be established as fixed capital not available for dividends."

(3) "Those which require no fixed or stated amount of capital stock and allow the corporation to determine what part, if any, of the consideration is fixed or stated capital and what part may be established as paid in surplus available for dividends."

Under the Delaware law the incorporators are left free to provide what part of the proceeds of the shares shall be set apart as fixed capital, and apparently all the contributions of the stockholders may be treated as a surplus fund available for dividends, if so specified. Fixed capital, then, would be only such as is voluntarily established by the corporation.¹⁷⁷

Capital contributions raised by the issue of no-par value stock cannot lawfully be withdrawn by the declaration of dividends or the purchase of shares any more than can the capital stock of a par value corporation. Corporations should be required to establish a fixed capital and should not be allowed to keep their entire assets subject to distribution at any time in the form of dividends. Among the various defects in the nonpar stock of many states may be mentioned the failure to provide for adequate responsibility to creditors by requiring a minimum paid-in capital as a condition of the right to do business; or making the requirement so low as to be merely formal. Statutes might also require the consideration for which the first issue of nonpar shares shall be sold to be stated in the certificate of incorporation, and periodical statements to be filed of the number of shares issued and the consideration received therefor; also the value of property acquired for stock to be appraised.

¹⁷⁷ It has been suggested that corporations might be required, as they are in some states, to credit the entire proceeds of any stock issue to capital account, or at least to credit not more than ten per cent to paid-in surplus as a reserve to equalize divi-

dends. This would help to prevent corporations from impairing their real capital under guise of distributing a so-called paid-in surplus. Bonbright, *Dangers of shares without par value*, 24 *Columbia Law Rev.* 449, 464, 466.

There is some difficulty in finding a basis for taxation of non-par stock. Some states arbitrarily place a fixed value, such as \$100 per share, for purposes of license and franchise taxes, without reference to the true value of the nonpar stock. In other states an arbitrary value per share is adopted according to what the parent state has fixed for purposes of franchise taxation in that state. In others a certain rate is fixed to be paid on each share without reference to the actual value of the shares.¹⁷⁸ In others a more scientific method is followed by estimating the amount of capital used by the corporation in the conduct of its business.

D. PERSONAL LIABILITY OF STOCKHOLDERS SUPERADDED BY CONSTITUTIONS AND STATUTES.

§ 218. In general.—Unless they are made so by express charter, statutory, or constitutional provisions, the stockholders or members of a corporation are not individually liable to creditors of the corporation, either for debts contracted by it, or for torts, even when they are indebted to the corporation for a balance on their stock. In most jurisdictions, however, individual liability to creditors is imposed upon stockholders of banks, and in some states of other corporations, by express statutory or constitutional provisions.

A court of equity, as we have seen, may compel the stockholders of a corporation, at the suit of creditors, to pay in any balance that may be due on the par value of their shares, when such payment is necessary in order to provide funds for paying the debts of the corporation. It may also give the creditor a remedy in case of bonus and watered stock.¹⁷⁹ This, however, is not holding the stockholders of the corporation personally liable for its debts, but is simply enforcing the obligation of the shareholder to pay up in good faith the par value of his shares and applying the

¹⁷⁸ *Roberts & Shaefer Co. v. Emerson*, 271 U. S. 50, 70 L. Ed. 827, 46 Sup. Ct. 375. A state may impose a franchise tax upon a domestic corporation measured by its authorized capital stock, and may measure it by the number of no-par value shares which may be issued, rather than by their value when issued. The differences between par value and no-par value stock are sufficient to justify classification and the assigning

of an arbitrary value to the no-par shares as the measure of the tax.

Taxation—no-par value stock, *Wickersham*, 39 *Harvard Law Rev.* 289. The only just tax on no-par stock is one measured by its actual value. In some states taxation upon an arbitrary value is held unconstitutional.

¹⁷⁹ *Ante*, §§ 199, 206, 210; *Fletcher, Corporations*, secs. 3589, 4095.

proceeds to the payment of its debts. It is well settled that stockholders are not personally liable for debts of the corporation, either at law or in equity, unless such liability is expressly imposed by the charter, or by some statutory or constitutional provision.¹⁸⁰

The reason is that a corporation is a legal entity or artificial person, distinct from the members who compose it, in their individual capacity; and when it contracts a debt, it is the debt of this legal entity or artificial person,—the corporation,—and not the debt of the individual members.¹⁸¹ This is one of the features which distinguishes a corporation at common law from an ordinary partnership, partners being individually liable for all the debts of the firm, however little they may have invested in the business. As we have seen, persons who undertake to do business as a corporation, and contract debts, after an ineffectual attempt to incorporate not sufficient to amount to a *de facto* corporation, or a corporation by estoppel, or without any attempt at all, may be personally liable as partners for the debts so contracted; but this is on the ground that there is no corporation at all, and that the debts are their individual debts.¹⁸²

If a corporation engages in an *ultra vires* undertaking and contracts debts or commits torts, stockholders do not become personally liable therefor because the corporation exceeds its pow-

¹⁸⁰ United States v. Stanford, 161 U. S. 412, 40 L. Ed. 751, 16 Sup. Ct. 576; Carr v. Iglehart, 3 Ohio St. 457; Freeland v. McCullough, 1 Denio (N. Y.) 414, 43 Am. Dec. 685; Trustees of Free Schools in Andover v. Flint, 13 Metc. (Mass.) 539; Auld v. Caunt, 216 Mass. 381, 103 N. E. 933; Reid v. Eatonton Mfg. Co., 40 Ga. 98, 2 Am. Rep. 563; Ireland v. Palestine, B., N. P. & N. W. Turnpike Co., 19 Ohio St. 369; Salt Lake City Nat. Bank v. Hendrickson, 40 N. J. Law 52 ("Personal responsibility can arise only out of some positive prescription by legislative act"); Gulf, C. & S. F. Ry. Co. v. Cities Service Co., 281 Fed. 214; Inter-ocean Newspaper Co. v. Robertson, 296 Ill. 92, 129 N. E. 523; Fletcher, Corporations, sec. 4137.

¹⁸¹ See ante, § 5; Wechselberg v. Flour City Nat. Bank, 64 Fed. 90, 26 L. R. A. 470 (no individual liability at common law beyond enforcement

of agreed contribution to the capital stock).

"As a general rule a corporation is regarded as an entity or person distinct from its shareholders, and obligations incurred by the corporation are regarded solely as obligations of the corporate entity or person. Whatever rights the creditors may have against the individual shareholders are regarded as rights derived indirectly through the corporation." Morawetz, Corporations, sec. 818. See Safeguarding rights of creditors, Warren, 36 Harvard Law Rev. 519.

¹⁸² Ante, §§ 19, 27; Harrill v. Davis, 168 Fed. 187, 22 L. R. A. (N. S.) 1153; New York Nat. Exch. Bank v. Crowell, 177 Pa. St. 313, 35 Atl. 613; Meyer v. Brunson, 104 S. O. 84, 88 S. E. 359. Compare, as to *de facto* corporations, Pochahontas Fuel Co. v. Tarboro Cotton Factory, — N. C. —, 93 S. E. 790 (stockholders not personally liable).

ers.¹⁸³ Nor do they become personally liable for corporate debts, in the absence of a statute, because assets of the corporation have been illegally distributed among or withdrawn by them, either before or after dissolution of the corporation. The remedy of creditors in such a case is in equity to compel restitution of the assets or their value, and their application to payment of the debts.¹⁸⁴

§ 219. Charter, statutory, or constitutional provisions imposing liability upon stockholders.

In most jurisdictions, individual liability for corporate debts or liabilities has been expressly imposed upon stockholders in banks by charter, statutory, or constitutional provisions. Individual liability in other classes of corporations was formerly often imposed to a greater or less extent, but these provisions have been repealed except in a few jurisdictions.

Particular provisions.—Sometimes a constitutional or statutory provision declares that stockholders shall be individually liable to creditors of the corporation to the amount due on their stock. Such a provision imposes no greater liability than exists in equity in the absence of any provision on the subject, although it may render stockholders liable directly to creditors.¹⁸⁵

Double liability.—As a general rule, in the case of banking corporations, the liability imposed upon stockholders is neither limited to the amount that may be due on their stock, nor unlimited, but

¹⁸³ *Mandeville v. Courtwright*, 126 Fed. 1007 (the fact that a corporation is engaged in a business which it is not authorized to carry on, viz. dentistry, and exceeds its powers by practicing in another state, does not render its stockholders liable as partners for the torts of its servants or agents in the conduct of such business); *Medill v. Collier*, 16 Ohio St. 599; *Second Nat. Bank of Cincinnati v. Hall*, 35 Ohio St. 158; *Searight Thornton & Co. v. Payne*, 2 Tenn. Ch. 175; *Staaeke v. Routledge*, 111 Tex. 489, 241 S. W. 994; 14 C. J. Corporations, p. 1033; sec. 1606, 3 Cook Corporations, (8th Ed.), sec. 682, p. 2736. But see *Hildebrand*, *The liability of stockholders of a corporation for torts in ultra vires undertakings*, 1 Texas Law Rev. 52, 57.

¹⁸⁴ *Vose v. Grant*, 15 Mass. 505; *Spear v. Grant*, 16 Mass. 9. But see

Fulton Auto Supply Co. v. Sullivan, 148 Ga. 347, 96 S. E. 875; *Martin v. Commonwealth*, 181 Ky. 212, 204 S. W. 84; *Martin v. City of Lexington*, 183 Ky. 714, 210 S. W. 483.

¹⁸⁵ See *Patterson v. Lynde*, 112 Ill. 196; s. c., 106 U. S. 519, 27 L. Ed. 265, 1 Sup. Ct. 432; *Mills v. Stewart*, 41 N. Y. 384; *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 668; *John W. Cooney Co. v. Arlington Hotel Co.*, 11 Del. Ch. 286, 101 Atl. 879; *Easton Nat. Bank v. American Brick & Tile Co.*, 70 N. J. Eq. 732, 64 Atl. 917, 8 L. R. A. (N. S.) 271, 10 Ann. Cas. 84; *Firestone Tire & Rubber Co. v. Agnew*, 194 N. Y. 165, 86 N. E. 1116, 24 L. R. A. (N. S.) 628, 16 Ann. Cas. 1150; *Clinton Mining & Mineral Co. v. Cochran*, 247 Fed. 449. See 25 Columbia Law Rev. 416.

is for an amount equal to the nominal or par value of their stock, in addition to what may have been paid or may be due therefor. Such is the effect of a provision that each stockholder in any corporation shall be liable for its debts "to the amount" of his stock, or "to the extent" of his stock, etc. Such a provision renders stockholders liable to the extent of the face value of their stock, although they may have paid for it in full, and does not mean simply that they shall be bound to pay once for their stock its face value. In other words, it imposes what is called a "double liability."¹⁸⁶ The National Bank Act provides that the shareholders of a national bank shall be individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such association to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares.¹⁸⁷

The California constitution makes each stockholder liable for such proportion of all debts and liabilities contracted or incurred during the time he was a stockholder as the amount of stock owned by him bears to the whole of the subscribed capital stock or shares of the corporation.¹⁸⁸ Any creditor of the corporation may institute an action against any of its stockholders for the proportion of his claim payable by each.

The statutes sometimes, instead of imposing an absolute liability upon stockholders for debts of the corporation, impose such

¹⁸⁶ *Willis v. Mabon*, 48 Minn. 140, 50 N. W. 1110, 16 L. R. A. 281, 31 Am. St. Rep. 626; *Selig v. Hamilton*, 234 U. S. 652, 58 L. Ed. 1518, 34 Sup. Ct. 926, Ann. Cas. 1917 A 104; *Miller v. Hammer*, 269 Fed. 891 (national banks); *Zang v. Wyant*, 25 Colo. 551, 56 Pac. 565, 71 Am. St. Rep. 145; *Kansas State Bank v. Laughlin*, 111 Kan. 520, 207 Pac. 433.

¹⁸⁷ *Ohio Valley Nat. Bank v. Hultitt*, 204 U. S. 162, 51 L. Ed. 423, 27 Sup. Ct. 179.

In order to ascertain the amount of the separate liability of each shareholder, it is necessary to ascertain the whole amount of the par value of all the stock held by all the shareholders, and the amount of the deficit to be paid after exhausting all the assets of the bank, and then to apply the rule that each shareholder shall contribute such sum as will bear the same proportion to the whole amount of the

deficit as his stock bears to the whole amount of the capital stock of the bank at its par value. The liability of all the shareholders together cannot exceed the entire amount of the capital stock of the bank at its par value, and the liability of no one shareholder can exceed such sum as bears the same proportion to the whole amount of the deficit to be paid as the stock held by him bears to the whole amount of the capital stock. *United States v. Knox*, 102 U. S. 422, 26 L. Ed. 216; *Pepper v. Springfield Institution for Savings*, 218 Fed. 814.

¹⁸⁸ Cal. Const., art. XII, sec. 3; Civil Code, sec. 322; *Sacramento Bank v. Pacific Bank*, 124 Cal. 147, 56 Pac. 787, 45 L. R. A. 863, 71 Am. St. Rep. 36; *Bridges v. Fick*, 53 Cal. App. 117, 200 Pac. 71; *National City Bank v. Chubb*, 52 Cal. App. 655, 199 Pac. 537; *Provident Gold Min. Co. v. Haynes*, 173 Cal. 44, 159 Pac. 155.

liability, either to the extent of their stock, or without any limit at all, until the whole amount of the capital stock, or a certain amount thereof, shall have been paid in, and a certificate thereof filed,¹⁸⁹ or in event of failure to comply with certain other requirements of the incorporation laws. In some jurisdictions there are statutes requiring corporations, or corporations of a particular class, to file an annual report, stating the amount of its capital stock, the amount paid in, and the amount of its existing indebtedness, or other facts which the public are interested in knowing, and providing that, if any corporation shall fail to do so, its stockholders shall be liable individually for its debts.¹⁹⁰

Charter or statutory provisions sometimes make stockholders liable, not for all debts of the corporation, but only for debts of a certain kind, as debts due laborers, servants, and employees, or for materials. The liability so imposed may be unlimited, except as to the character of the indebtedness, or it may be limited. Generally, if not always, the liability is over and above, and without reference to, the amount paid for or due upon the stock.¹⁹¹

Power of the legislature.—The legislature clearly has the power to impose upon the stockholders of a corporation individual liability for its debts to any extent it may see fit, unless controlled by special constitutional provisions, if it imposes the liability at the time the corporation is created. It may also impose such liability after a corporation has been created or formed, as to future debts, although not as to debts already contracted, if it has reserved the right to alter, amend, or repeal the charter of the corporation.¹⁹² When, as is sometimes the case, the constitution of a state makes

Western Pac. Ry. Co. v. Godfrey, 166 Cal. 346, 136 Pac. 284, Ann. Cas. 1915 B 825.

¹⁸⁹ Shadbolt & Boyd Iron Co. v. Long, 172 Wis. 591, 179 N. W. 785; American Ice Cream Mfg. Co. v. Economy Laundry Co., 148 Ga. 624, 97 S. E. 678.

¹⁹⁰ Cable v. McCune, 26 Mo. 371, 72 Am. Dec. 214; Wing v. Slater, 19 R. I. 597, 35 Atl. 302, 33 L. R. A. 566; Spear v. Olson, 104 Neb. 139, 175 N. W. 1012; Bourne v. Baer, 107 Neb. 255, 185 N. W. 408.

¹⁹¹ Milroy v. Spurr Mountain Iron Min. Co., 43 Mich. 231, 5 N. W. 287; Hitchcock v. Pagenstecher, 198 N. Y. App. Div. 511, 190 N. Y. Supp. 706; Card v. Groesbeck, 204 N. Y.

301, 97 N. E. 728; Shurlock v. Lewis, 170 Mich. 493, 136 N. W. 484, 41 L. R. A. (N. S.) 975; Jackson v. Meek, 87 Tenn. 69, 9 S. W. 225, 10 Am. St. Rep. 620.

¹⁹² Sherman v. Smith, 1 Black (U. S.) 587, 17 L. Ed. 163; Gardner v. Hope Ins. Co., 9 R. I. 194, 11 Am. Rep. 238; United States Trust Co. v. United States Fire Ins. Co., 18 N. Y. 199; Bailey v. Hollister, 26 N. Y. 112; First Nat. Bank v. Multnomah State Bank, 87 Ore. 423, 170 Pac. 534; Sleeper v. Goodwin, 67 Wis. 577, 31 N. W. 335; Duke v. Force, 120 Wash. 599, 208 Pac. 67, 23 A. L. R. 1354; McGowan v. McDonald, 111 Cal. 57, 43 Pac. 418, 52 Am. St. Rep. 149.

the stockholders of a corporation liable for its debts, and fixes the liability, or prescribes the liability which the legislature shall impose, the legislature, of course, has no power to exempt them from liability, or to impose a different liability.¹⁹³ If the constitution, however, merely provides that stockholders shall be individually liable for corporate debts, without fixing the extent of their liability, or prescribing the mode of enforcing it, these questions are referred to the legislature, and it has the power to determine the extent to which the stockholders shall be liable, and the mode in which their liability shall be enforced; and when the constitution fixes the extent of the liability, the legislature may prescribe the mode of enforcing it.¹⁹⁴

§ 220. Corporate liabilities to which the statutory or constitutional provisions apply.

The statutory and constitutional provisions imposing individual liability upon stockholders of corporations differ in the terms which they use to designate the obligations to which the liability shall extend. Among the terms used are "debts," "demands," "debts and contracts," "debts contracted," "dues," "indebtedness," and the like. In construing these terms, the courts have not agreed.

Liabilities arising out of contract.—All of the courts agree, no doubt, that these terms are broad enough to include any obligation on the part of a corporation arising out of contract. The term "debts" in such a statute is not used in the technical sense, so as to be limited to such demands as will sustain a common-law action of debt, but includes a claim for unliquidated damages arising out of breach of contract, express or implied.¹⁹⁵

¹⁹³ *Western Pac. R. Co. v. Godfrey*, 166 Cal. 346, 136 Pac. 284, Ann. Cas. 1915 B 825; *McGowan v. McDonald*, 111 Cal. 57, 43 Pac. 418, 52 Am. St. Rep. 149; *Foster v. Row*, 120 Mich. 1, 79 N. W. 696, 77 Am. St. Rep. 565; *State v. Sherman*, 22 Ohio St. 411; *Anderson v. Anderson Iron Co.*, 65 Minn. 281, 68 N. W. 49, 33 L. R. A. 510; *Way v. Barney*, 116 Minn. 285, 133 N. W. 801, 38 L. R. A. (N. S.) 648, Ann. Cas. 1913 A 719; *Van Pelt v. Gardner*, 54 Neb. 701, 75 N. W. 874.

¹⁹⁴ *Gardiner v. Bank of Napa*, 160 Cal. 577, 117 Pac. 667; *Selig v. Ham-*

ilton, 234 U. S. 652, 56 L. Ed. 749, 34 Sup. Ct. 926, Ann. Cas. 1917 A 104; *Larrabee v. Baldwin*, 35 Cal. 155; *French v. Teschemaker*, 24 Cal. 518; *Hampson v. Weare*, 4 Iowa 13, 66 Am. Dec. 116; *Willis v. Mabon*, 48 Minn. 140, 50 N. W. 1110, 6 L. R. A. 281, 31 Am. St. Rep. 626; *Milroy v. Spurr Mountain Iron Min. Co.*, 43 Mich. 231, 5 N. W. 287.

¹⁹⁵ *Proprietors of Mill Dam Foundry v. Hovey*, 21 Pick (Mass.) 417; *Haynes v. Brown*, 36 N. H. 545; *Dryden v. Kellogg*, 2 Mo. App. 87; *Chase v. Curtis*, 113 U. S. 452, 8 L. Ed. 1038, 5 Sup. Ct. 554. But see

Claims under *ultra vires* contracts.—In a Supreme Court case it was held that, while the word “dues” in the provision of the Kansas constitution that “dues from corporations” shall be secured by individual liability of the stockholders is a comprehensive term, and includes all contractual obligations of corporations, it cannot, under the rule of equitable construction applicable to constitutional provisions, be construed, as against a stockholder, to include a contract which is *ultra vires*, although, under the local rule, the corporation itself may be estopped, by having received the benefits of the contract, from setting up its *ultra vires* character to defeat an action thereon.¹⁹⁶ There is, however, a conflict of authority whether statutory or constitutional provisions imposing upon stockholders liability to creditors can be construed to extend to debts of the corporation arising out of *ultra vires* transactions.

Liability based upon tort.—Whether a constitutional or statutory provision imposing individual liability upon stockholders includes liabilities of the corporation arising out of a tort is not always clear, and, in construing some of the terms used, the courts have differed. It seems very clear that the term “contracts,” used in such a statute, cannot be held to include liabilities arising out of tort. Some of the courts have gone further, and held that a statute making stockholders liable for “debts” of the corporation is intended to apply to such obligations only as arise on express or implied contracts growing out of dealings between the corporation and other corporations or individuals where the financial condition of the corporation would or might be the foundation of credit, and that it does not render stockholders liable for an unliquidated claim for damages for a tort committed by the officers or agents of the corporation,¹⁹⁷ even though the tort might have been waived, and

Clinton Mining & Mineral Co. v. Beacom, 266 Fed. 621, 14 A. L. R. 263; Avery & Sons v. McClure, 94 Miss. 172, 47 So. 901, 22 L. R. A. (N. S.) 256, 19 Ann. Cas. 134. See also, 5 California Law Rev. 248.

¹⁹⁶ Ward v. Joslin, 186 U. S. 142, 46 L. Ed. 1093, 22 Sup. Ct. 807 (corporation's *ultra vires* guaranty of notes); State ex rel. Hilton v. Mortgage Security Co., Inc., 154 Minn. 453, 192 N. W. 348. See note, Does stockholders' double liability extend to *ultra vires* debts on the corporation? 7 Minnesota Law Rev. 500; Leighton v. Leighton Lea Ass'n, 74 N. Y. Misc.

229, 131 N. Y. Supp. 561. But compare Kipp v. Miller, 47 Colo. 598, 108 Pac. 164, 135 Am. St. Rep. 236 (stockholders had actual or presumptive knowledge of transaction); Connecticut River Sav. Bank v. Fisk, 60 N. H. 363; Ball v. Reese, 58 Kan. 614, 50 Pac. 875, 62 Am. St. Rep. 638. See also Peet v. Des Moines Sav. Bank, 190 Iowa 1020, 181 N. W. 503.

¹⁹⁷ Doolittle v. Marsh, 11 Neb. 243, 9 N. W. 54; Cable v. McCune, 26 Mo. 371, 72 Am. Dec. 214; Child v. Boston & Fairhaven Iron Works, 137 Mass. 516, 50 Am. Rep. 328. Clin-

an action *ex contractu* maintained against the corporation.¹⁹⁸ It has also been held that a judgment recovered against the corporation for a tort is not such a "debt" as is contemplated by the statutes.¹⁹⁹

Other courts have construed the word "debts" or "indebtedness" more broadly, and have held that it includes any just demand against the corporation, although the demand may be for unliquidated damages for a tort, as for infringement of a patent,²⁰⁰ and that the word "debt" or "indebtedness" in a statute imposing liability upon stockholders includes a judgment recovered against the corporation for a tort.²⁰¹ A stockholder is liable for the torts of the corporation under a statute making stockholders individually liable "for all acts of and contracts made by" the company.²⁰² A provision imposing liability for the "debts and liabilities" of the corporation includes liability arising out of a tort.²⁰³

Debts due laborers, servants, clerks, employees, etc.—A charter or statutory provision sometimes makes the stockholders of a corporation liable for special debts only, as debts due from the corporation to laborers, servants, apprentices, clerks, employees, etc. Under such a provision, of course, a creditor of a corporation cannot collect his demand from the stockholders unless he shows that it is such a demand as to come within the terms of the statute, and the burden of showing this is upon him.²⁰⁴ Under a

ton Mining & Mineral Co. v. Beacom, 266 Fed. 621 (South Dakota statute), aff'g 264 Fed. 228, 14 A. L. R. 263. See note. Statutory liability of stockholder for tort of corporation, in 14 A. L. R. 267; 4 California Law Rev. 243.

¹⁹⁸ Heacock v. Sherman, 14 Wend. (N. Y.) 58; Bohn v. Brown, 33 Mich. 257; Cable v. McCune, 26 Mo. 371, 72 Am. Dec. 214.

¹⁹⁹ Bohn v. Brown, 33 Mich. 257; Brown v. Trail, 89 Fed. 641; Clinton Mining & Mineral Co. v. Beacom, 266 Fed. 621, 14 A. L. R. 263. See note, 34 Harvard Law Rev. 329, 330.

²⁰⁰ Carver v. Braintree Mfg. Co., 2 Story 432, Fed. Cas. No. 2485.

²⁰¹ Powell v. Oregonian Ry. Co., 36 Fed. 726; s. c., 38 Fed. 187; Henley v. Myers, 76 Kan. 723, 736, 93 Pac. 168, 173, 17 L. R. A. (N. S.) 779; Frost v. St. Paul Banking & Invest-

ment Co., 57 Minn. 325, 59 N. W. 308. See notes, 15 Columbia Law Rev. 354; 16 Columbia Law Rev. 346; 4 California Law Rev. 243; 5 California Law Rev. 248.

²⁰² Kelly v. Clark, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 668.

²⁰³ Damiano v. Bunting, 40 Cal. App. 566, 181 Pac. 232; Lininger v. Botsford, 32 Cal. App. 386, 163 Pac. 63; 5 California Law Rev. 248. Where the term "debt" is used, it should be construed to apply only to claims arising out of contract, but where the terms "dues," "demands," "claims," "all acts" or "liabilities" are used they include torts as well as contracts.

²⁰⁴ Moyer v. Pennsylvania Slate Co., 71 Pa. St. 293; Hill v. Spencer, 61 N. Y. 274; Wakefield v. Fargo, 90 N. Y. 213; Bristol v. Smith, 158 N.

statute making the stockholders individually liable, in addition to the liability of the corporation, for the wages of servants and employees of the corporation, an employee does not waive his rights against individual stockholders by taking a note from the corporation for the amount due him, or by obtaining a judgment against the corporation on the note, and receiving a *pro rata* payment thereon out of the assets of the company.²⁰⁵

§ 221. Whether the liability of stockholders is primary or secondary.

When a statute provides that stockholders of a corporation shall be individually and personally liable for its debts, and does not expressly or by necessary implication require that creditors shall proceed against the corporation and exhaust their remedies against it before proceeding against the stockholders, the liability of the stockholders to creditors is primary, and not secondary, and creditors may sue and collect from them to the extent of their liability, without first exhausting their remedies against the corporation by recovering a judgment against it, and issuing an execution thereon, or otherwise.²⁰⁶ It has been so held, for example, under a provision that each stockholder of a corporation "shall be individually and personally liable for such proportion of all its debts and liabilities as the amount of its capital stock owned by him bears to the whole of the capital stock."²⁰⁷

Statutes thus imposing upon stockholders a primary liability for corporate debts, which may be enforced by creditors without exhausting their remedies against the corporation, are the exception. Generally, the statutes impose a secondary liability,—a liability to be resorted to only in case the assets of the corporation shall be insufficient to satisfy its debts,—and, in such a case, creditors can-

Y. 157, 53 N. E. 42, *aff'g* 29 N. Y. App. Div. 624, 52 N. Y. Supp. 1138; *Brockway v. Innes*, 39 Mich. 47, 33 Am. Rep. 348; *Jones v. Avery*, 50 Mich. 326, 15 N. W. 494; *Sleeper v. Goodwin*, 67 Wis. 577, 31 N. W. 335; *Shurlov v. Lewis*, 170 Mich. 493, 136 N. W. 484, 41 L. R. A. (N. S.) 975; *Card v. Groesbeck*, 204 N. Y. 301, 97 N. E. 728. See *Tyer v. Cole* — Okla. —, 248 Pac. 601; 27 Columbia Law Rev. 96.

²⁰⁵ *Jackson v. Meek*, 87 Tenn. 69, 9 S. W. 225, 10 Am. St. Rep. 620.

²⁰⁶ *Ellsworth v. Bradford*, 186 Cal.

316, 199 Pac. 335; *Knowles v. Sandercock*, 107 Cal. 629, 40 Pac. 1047; *McGowan v. McDonald*, 111 Cal. 57, 43 Pac. 418, 52 Am. St. Rep. 149; *Culver v. Third Nat. Bank*, 64 Ill. 528; *Schalucky v. Field*, 124 Ill. 617, 16 N. E. 904, 7 Am. St. Rep. 399; *Golden v. Cervenka*, 278 Ill. 409, 116 N. E. 273; *Parker v. Carolina Sav. Bank*, 53 S. C. 583, 31 S. E. 673, 69 Am. St. Rep. 888; *McMahon v. Macy*, 51 N. Y. 155.

²⁰⁷ *Morrow v. Superior Court*, 64 Cal. 383; *Knowles v. Sandercock*, 107 Cal. 629, 40 Pac. 1047.

not sue stockholders to enforce their liability until they have exhausted their legal remedy against the corporation by recovery of a judgment against it, and return of an execution wholly or partly unsatisfied, or unless they show that this was impossible, or would have been useless.²⁰⁸

§ 222. Who are liable as stockholders under statutory or constitutional provisions.

In general.—It is clear that a person cannot be held liable for corporate debts under a charter, statutory, or constitutional provision imposing such liability upon stockholders, unless he has, at the very least, at some time become a stockholder in the corporation, or unless the circumstances are such as to estop him from denying that he is or was a stockholder.²⁰⁹ But if a person is in fact the owner of stock, he cannot escape individual liability as a stockholder by showing that the stock has never been entered in his name or transferred to him on the books of the corporation.²¹⁰

Other corporations.—Whether a corporation which has subscribed for or purchased stock in another corporation incurs a statutory liability for corporate debts depends, first, upon whether the subscription or purchase was *ultra vires* or not, and, second, if it was *ultra vires*, upon whether it can repudiate the subscription, and set up such a defense as against creditors of the other corporation. If a corporation has the power to take and hold stock in

²⁰⁸ *Flash v. Conn*, 109 U. S. 371, 27 L. Ed. 966, 3 Sup. Ct. 263; *Fourth Nat. Bank of New York v. Franklyn*, 120 U. S. 747, 30 L. Ed. 825, 7 Sup. Ct. 757; *Macomber v. Wright*, 108 Mich. 109, 65 N. W. 610; *Balls v. Wicks*, 45 Neb. 367, 63 N. W. 806; *Handy v. Draper*, 89 N. Y. 334; *Rocky Mountain Nat. Bank v. Bliss*, 89 N. Y. 338; *Bronson v. Schneider*, 49 Ohio St. 438, 33 N. E. 438; *Barrick v. Gifford*, 47 Ohio St. 180, 24 N. E. 259, 21 Am. St. Rep. 798; *Fremont State Bank v. Vincent*, 112 Wash. 493, 192 Pac. 975.

²⁰⁹ *Golden v. Ellwood*, 299 Ill. 73, 132 N. E. 223; *Converse v. Stewart*, 197 Fed. 152; *Converse v. Stewart*, 192 N. Y. 578, 85 N. E. 1107; *Security State Bank v. Gannon*, 39 S. D. 232, 163 N. W. 1040 (estoppel).

A person is not liable as a stock-

holder merely because his name appears on a subscription paper or on the corporate books as a subscriber or stockholder, if it was placed there without his consent, and he has not acquiesced therein, or because of a transfer of stock to him without his consent, unless he had notice of the transfer, and acquiesced therein. *Stephens v. Follett*, 43 Fed. 842; *Mudgett v. Horrell*, 33 Cal. 25; *Fowler v. Ludwig*, 34 Me. 455. See *Rosenfeld v. Horwich*, 221 Ill. App. 304. See also, note, "Liability of one whose name appears upon corporate books as a stockholder without his consent," to *Shean v. Cook*, 180 Cal. 92, 179 Pac. 185, in 3 A. L. R. 1042, 1049.

²¹⁰ *Foster v. Row*, 120 Mich. 1, 79 N. W. 696, 77 Am. St. Rep. 565.

another corporation, and does so, it is clearly liable to creditors of the other corporation to the same extent as any other stockholder.²¹¹ It is equally clear that in those jurisdictions in which it is held that a corporation which enters into an *ultra vires* contract and receives the benefit of the contract cannot set up the defense of *ultra vires* to escape liability thereon, a corporation which has made an *ultra vires* subscription for or purchase of stock in another corporation, and has received and held the stock, cannot set up its want of power to take and hold the stock for the purpose of escaping liability as a stockholder to creditors.²¹²

In those jurisdictions, however, in which it is held that, when a corporation enters into a contract which is beyond its powers, the contract is absolutely void, and the corporation is not estopped to set up the defense of *ultra vires* to escape liability thereon because it has received the benefit, it has been held that, when a corporation is not authorized by its charter to subscribe for or purchase stock in another corporation for any purpose, so that its taking and holding stock is altogether beyond its powers, and it does subscribe for or purchase stock, and receives and holds the same until the other corporation becomes insolvent, it may nevertheless set up its want of power to defeat an action against it to enforce a statutory liability to creditors.²¹³ Even in these jurisdictions, however, it is held that, if a corporation has the power, under some circumstances, to acquire and hold stock in another corporation, and it exceeds its powers by acquiring and holding stock for an unauthorized purpose, it cannot set up the *ultra vires* character of the transaction to escape liability as a stockholder to creditors.²¹⁴

²¹¹ In re Asiatic Banking Corp., 4 Ch. App. 252; National Bank v. Case, 99 U. S. 628, 25 L. Ed. 448; Citizens' State Bank v. Hawkins, 71 Fed. 369; Kennedy v. California Sav. Bank, 101 Cal. 495, 35 Pac. 1039, 40 Am. St. Rep. 69.

²¹² See Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co., 127 N. Y. 252, 27 N. E. 831, 24 Am. St. Rep. 448; Olson v. Warroad Mercantile Co., 136 Minn. 310, 161 N. W. 713; Hunt v. Hauser Malting Co., 95 Minn. 206, 103 N. W. 1032; s. c., 90 Minn. 282, 96 N. W. 85.

²¹³ First Nat. Bank v. Converse, 200 U. S. 425, 50 L. Ed. 537, 26 Sup. Ct. 306; California Nat. Bank v. Kennedy, 167 U. S. 362, 42 L. Ed. 198, 17

Sup. Ct. 831, rev'g Kennedy v. California Sav. Bank, 101 Cal. 495, 35 Pac. 1039, 40 Am. St. Rep. 69; First Nat. Bank of Concord v. Hawkins, 174 U. S. 364, 43 L. Ed. 1007, 19 Sup. Ct. 739, rev'g 79 Fed. 51; Knowles v. Sandercock, 107 Cal. 629, 40 Pac. 1047. See Warren, Executed *ultra vires* transactions, 23 Harvard Law Rev. 495, 510: "Should a corporation which has the benefits of ownership be allowed to escape the liabilities?"

²¹⁴ Germania Nat. Bank of New Orleans v. Case, 99 U. S. 628, 25 L. Ed. 448; Citizens' State Bank of Noblesville v. Hawkins, 71 Fed. 369; Kennedy v. California Sav. Bank, 101 Cal. 495, 35 Pac. 1039, 40 Am. St.

Real and apparent owner.—Trustees, agents, etc.—Election.—

The general rule is that the person who appears on the books of the corporation is liable as a stockholder to creditors, although he may not be the real owner of the stock. Thus, as we shall hereafter see, a transferrer of stock remains liable as a stockholder if he continues to appear as a stockholder on the books.²¹⁵ And in the absence of provision to the contrary, a person who appears on the books of a corporation as a stockholder is liable to creditors under a provision imposing individual liability upon stockholders, although he may in fact hold the stock merely as trustee or agent or broker, and may in fact have no beneficial interest therein.²¹⁶ It has been held that a person is liable as a stockholder, although it appears on the books that he holds the stock as trustee,²¹⁷ but the better opinion is to the contrary.²¹⁸ When a person holds stock merely as trustee or agent for another, but appears on the books of the corporation as the real owner, creditors of the corporation may hold either the real or the apparent owner liable.²¹⁹

In some jurisdictions it is expressly provided by statute that persons holding stock in a representative capacity, as trustee, executor, guardian, etc., shall not be personally liable as stockholders, but that the person or estate represented shall be liable.²²⁰

Liability of pledgees.—In the absence of statutory provision to the contrary, a person who appears on the books of a corporation as a stockholder is liable as such to creditors, although the stock may have been transferred to him merely as collateral se-

Rep. 69, as construed in the later case of *Knowles v. Sandercock*, 107 Cal. 629, 40 Pac. 1047.

²¹⁵ *Infra*, this section.

²¹⁶ *Grew v. Breed*, 10 Metc. (Mass.) 569; *Crease v. Babcock*, 10 Metc. (Mass.) 525; *Welles v. Larrabee*, 36 Fed. 866, 2 L. R. A. 471; *Adderly v. Storm*, 6 Hill (N. Y.) 624; *United States Trust Co. v. United States Fire Ins. Co.*, 18 N. Y. 199; *Kirschler v. Wainwright*, 255 Pa. 525, 100 Atl. 484, L. R. A. 1917 E 393.

²¹⁷ *Grew v. Breed*, 10 Metc. (Mass.) 569; *Flynn v. American Banking & Trust Co.*, 104 Me. 141, 69 Atl. 771, 19 L. R. A. (N. S.) 428, 129 Am. St. Rep. 378.

²¹⁸ *Welles v. Larrabee*, 36 Fed. 866, 2 L. R. A. 471; *Adderly v. Storm*, 6 Hill (N. Y.) 628.

A person holding in trust an estate

consisting in part of corporate stock, when not personally liable, is bound to contribute from the trust property in his hands. *Sayles v. Bates*, 15 R. I. 342, 5 Atl. 497. And see *Richmond v. Irons*, 121 U. S. 27, 30 L. Ed. 864, 7 Sup. Ct. 788.

²¹⁹ *Houghton v. Hubbell*, 91 Fed. 453; *Dunn v. Howe*, 107 Fed. 849; *Blackburn v. Irvine*, 205 Fed. 217; *Geary, St. P. & O. R. Co. v. Rolph*, 189 Cal. 59, 207 Pac. 539.

²²⁰ *Smathers v. Western Carolina Bank*, 155 N. C. 283, 71 S. E. 345, Ann. Cas. 1912 C 398. See *Golden v. Ellwood*, 299 Ill. 73, 132 N. E. 223; *Converse v. Paret*, 228 Pa. 156, 77 Atl. 429, 30 L. R. A. (N. S.) 1092. As to national banks, see *Miller v. Hamner*, 269 Fed. 891; *Williams v. Cobb*, 242 U. S. 307, 61 L. Ed. 325, 37 Sup. Ct. 115.

curity.²²¹ But a person to whom a certificate of stock has been transferred as collateral security is not liable as a stockholder if the stock has not been transferred to him at all on the books of the corporation, or if it has been transferred to him in terms, not as absolute owner, but as pledgee merely.²²² In some jurisdictions it is expressly provided by statute that persons holding stock merely as collateral security shall not be liable as stockholders, but that the pledgor shall be liable; and under such a provision it has been held that a person who has taken a transfer of stock absolute on its face may escape liability to creditors by showing that the transfer was in fact as collateral security merely.²²³ But it is generally held that the pledgee will be liable, unless it is made to appear on the books that he holds the stock as such and not as absolute owner.

Effect of transfers of stock on individual liability for corporate debts.—There has been much difficulty in construing provisions for the purpose of determining the effect of transfers of stock upon the individual liability of stockholders, and the decisions on the question are conflicting. Under provisions simply making “the stockholders” of a corporation liable for its debts, some of the courts have held that individual liability for a debt attaches to those persons, and to those persons only, who were stockholders at the time the debt was contracted,—that persons who have become stockholders since the debt was contracted are not liable, and that persons who were stockholders at the time it was contracted are not relieved from liability by the fact that they have since transferred their stock, and ceased to be stockholders.²²⁴

²²¹ *Germania Nat. Bank of New Orleans v. Case*, 99 U. S. 628, 25 L. Ed. 448; *Anderson v. Philadelphia Warehouse Co.*, 111 U. S. 479, 28 L. Ed. 478, 4 Sup. Ct. 525; *State v. Bank of New England*, 70 Minn. 398, 73 N. W. 153, 68 Am. St. Rep. 538. See *Skinner v. Home Bank of Brooklyn*, 190 N. Y. App. Div. 187, 179 N. Y. Supp. 567.

²²² *Henkle v. Salem Mfg. Co.*, 39 Ohio St. 547; *Anderson v. Philadelphia Warehouse Co.*, 111 U. S. 479, 28 L. Ed. 478, 4 Sup. Ct. 525; *First Nat. Bank of Barre v. Hingham Mfg. Co.*, 127 Mass. 563; *Robinson v. Southern Nat. Bank*, 180 U. S. 295, 45 L. Ed. 536, 21 Sup. Ct. 383; *Ohio Valley Nat. Bank v. Hulitt*, 204 U. S. 162, 51 L. Ed. 423, 27 Sup. Ct. 179; *Ran-*

kin v. Fidelity Insurance, Trust & Safe-Deposit Co., 189 U. S. 242, 47 L. Ed. 792, 23 Sup. Ct. 553; *Marshall Field & Co. v. Evans, Johnson, Sloane & Co.*, 106 Minn. 85, 118 N. W. 55, 19 L. R. A. (N. S.) 249.

²²³ *McMahon v. Macy*, 51 N. Y. 155; *Union Sav. Ass'n v. Seligman*, 92 Mo. 635, 15 S. W. 630, 1 Am. St. Rep. 776; *Borland v. Nevada Bank of San Francisco*, 99 Cal. 89, 33 Pac. 737, 37 Am. St. Rep. 32; *May v. Genesee County Sav. Bank*, 120 Mich. 330, 79 N. W. 630; *Tierney v. Ledden*, 143 Iowa 286, 121 N. W. 1050, 21 Ann. Cas. 105. See 10 Ann. Cas. 783.

²²⁴ *Williams v. Hanna*, 40 Ind. 535; *Norris v. Johnson*, 34 Md. 485; *Chesley v. Pierce & Sawyer*, 32 N. H. 388; *Moss v. Oakley*, 2 Hill (N. Y.) 265;

In other states the courts have held that those persons, and those persons only, are liable who are stockholders at the time the liability is enforced. Under a charter providing that the members of the corporation should at all times be liable for all debts due by the corporation, it was held that persons who were members of the corporation at the time a debt was contracted, but who had transferred their stock before commencement of an action to enforce their liability, were not liable.²²⁵ And where a statute provided that the stockholders of a corporation should be individually responsible, to the amount of their respective shares of stock, for all of its indebtedness and liabilities, it was held that it was not the persons who were stockholders at the time the debts accrued who were liable, but those who were stockholders at the time the action was commenced.²²⁶

Sometimes the statutes contain an express provision as to the effect of a *bona fide* transfer on the liability of the parties, and thus leave no room for doubt as to the meaning. The National Banking Act, for example, expressly provides that, in the case of a transfer of shares, the transferee shall succeed to all the liabilities of the transferor, and under this provision a *bona fide* and complete transfer of shares relieves the transferor from any further liability, even for debts contracted before the transfer, and the transferee becomes liable.²²⁷ On the other hand, a statute sometimes expressly provides that a transfer of stock shall not relieve the transferor from liability for debts previously contracted.²²⁸ By

Jackson v. Meek, 87 Tenn. 69, 9 S. W. 225, 10 Am. St. Rep. 620.

In some states the statute so provides in express terms. Larrabee v. Baldwin, 35 Cal. 155. See Bottlers' Seal Co. v. Rainey, 225 N. Y. 369, 122 N. E. 200.

²²⁵ Middleton Bank v. Magill, 5 Conn. 28.

²²⁶ Cleveland v. Burnham, 55 Wis. 598, 13 N. W. 677, 680. See also, Barton Nat. Bank v. Atkins, 72 Vt. 33, 77 Atl. 176; First Nat. Bank of Winona v. Winona Plow Co., 58 Minn. 167, 59 N. W. 997; Foster v. Row, 120 Mich. 1, 79 N. W. 696, 77 Am. St. Rep. 565; Skrainka v. Allen, 76 Mo. 384; Van Demark v. Barons, 52 Kan. 779, 35 Pac. 798; Chatham Bank of Savannah v. Brobston, 99 Ga. 801, 27 S. E. 790.

²²⁷ Johnson v. Laffin, 5 Dill. 65, Fed. Cas. No. 7393; Johnston v. Laf-

lin, 103 U. S. 800, 26 L. Ed. 532; Whitney v. Butler, 118 U. S. 655, 30 L. Ed. 266, 7 Sup. Ct. 61.

²²⁸ White v. Green, 105 Iowa 176, 74 N. W. 928; Gunnison v. United States Inv. Co., 70 Minn. 292, 73 N. W. 149; Way v. Mooers, 135 Minn. 339, 160 N. W. 1014, L. R. A. 1918 B 559; Selig v. Hamilton, 234 U. S. 652, 58 L. Ed. 1518, 34 Sup. Ct. 926, Ann. Cas. 1917 A 104. Compare as to bank stock in Minnesota, Northwestern Trust Co. v. Bradbury, 112 Minn. 76, 127 N. W. 386.

In Gunnison v. United States Inv. Co., 70 Minn. 292, 295, 73 N. W. 149, the Minnesota court said that "by virtue of the statute a stockholder cannot relieve himself from the liability for the prior debts of the corporation by a *bona fide* sale and transfer of his stock on the books of the corporation, whatever the rule

the weight of authority, when there is a charter or statutory provision that transfers must be made or registered on the books of the corporation, an unregistered transfer, although it may be good as between the parties, is not good as against creditors, and will not relieve the transferrer from his statutory or double liability, nor for his subscription liability for the unpaid balance due on his stock.²²⁹ According to the better opinion, if a stockholder sells his stock and delivers to the proper officer of the corporation his certificate of stock with a power of attorney which is sufficient to effect a transfer of his stock on the books, this is sufficient to put an end to his liability, although the corporation may neglect to register the transfer.²³⁰

If a transfer is made in good faith and to a responsible person, it is none the less effectual to relieve the transferrer from liability because it is made for the purpose of escaping liability.²³¹ But a transfer for the purpose of escaping liability will not relieve the transferrer, if it is merely colorable, and he remains the beneficial owner.²³² In most jurisdictions in which the question has arisen it has been held that, when a corporation is in failing circumstances, a transfer of stock for the purpose of escaping liability to creditors, to a person who is known to be insolvent, or who, for any other reason, is irresponsible, is a fraud upon cred-

may be in the absence of the statute."

²²⁹ *Realty & Rebuilding Co. v. Rea*, 184 Cal. 565, 194 Pac. 1024; *Hunt v. Seeger*, 91 Minn. 264, 98 N. W. 91; *Shellington v. Howland*, 53 N. Y. 371; *Powers v. Knapp*, 71 Hun (N. Y.) 371, 25 N. Y. Supp. 19, s. c., 158 N. Y. 733, 53 N. E. 1131; *Irons v. Manufacturers' Nat. Bank*, 27 Fed. 591; *Richmond v. Irons*, 121 U. S. 27, 30 L. Ed. 864, 7 Sup. Ct. 788; *Matteson v. Dent*, 176 U. S. 521, 44 L. Ed. 571, 20 Sup. Ct. 419; *Dane v. Young*, 61 Me. 160; *Herrick v. Wardwell*, 58 Ohio St. 294, 50 N. E. 903.

In California the transfer of shares of stock to become effectual between the transferor and the creditors of the corporation must be entered on the corporate books; otherwise he is not relieved from liability under the statute. *Realty & Rebuilding Co. v. Fillmore Arcade Co.*, 65 Cal. App. 757, 224 Pac. 1020; *Sherman v. S. K. D. Oil Co.*, 185 Cal. 534, 548, 197

Pac. 799; *Spreckles v. Nevada Bank*, 113 Cal. 272, 45 Pac. 329, 33 L. R. A. 439, 54 Am. St. Rep. 348.

²³⁰ *Whitney v. Butler*, 118 U. S. 655, 30 L. Ed. 266, 7 Sup. Ct. 61; *Cox v. Elmendorf*, 97 Tenn. 518, 37 S. W. 387; *Keyes v. Myhre*, 143 Minn. 193, 173 N. W. 422. And see *Foster v. Row*, 120 Mich. 1, 79 N. W. 696, 77 Am. St. Rep. 565. *Contra*, *Harpold v. Stobart*, 46 Ohio St. 397, 21 N. E. 637, 15 Am. St. Rep. 618.

²³¹ *Magruder v. Colston*, 44 Md. 349, 22 Am. Rep. 47; *Miller v. Great Republic Ins. Co.*, 50 Mo. 55.

²³² *Hyam's Case*, 1 De Gex, F. & J. 75; *Germania Nat. Bank of New Orleans v. Case*, 99 U. S. 628, 25 L. Ed. 448; *McDonald v. Dewey*, 202 U. S. 510, 50 L. Ed. 1128, 26 Sup. Ct. 731, 6 Ann. Cas. 419; *Pioneer Fuel Co. v. St. Peter Street Improvement Co.*, 64 Minn. 386, 67 N. W. 217; *Peter v. Union Mfg. Co.*, 56 Ohio St. 181, 146 N. E. 894.

itors of the corporation, and void as to them.²³³ If a transfer is made in good faith, and not for the purpose of defeating creditors, the mere fact that the transferee is insolvent will not render the transferrer liable to creditors; nor will he remain liable merely because the corporation was in a failing condition at the time of the transfer, unless it is shown that he knew of this fact, and made the transfer in anticipation of insolvency, and for the purpose of escaping liability.²³⁴ A person who transfers stock to an infant will remain liable to creditors unless the infant has attained his majority and ratified the transfer.²³⁵ And a stockholder is not relieved from liability as such by a transfer to the corporation itself.²³⁶

§ 223. Who may enforce the individual liability of stockholders.

In the absence of provision to the contrary, the individual liability for corporate debts imposed upon the stockholders of a corporation by statute is solely for the benefit of, and directly to, creditors, and can only be enforced by them or by a receiver or official who represents them. The liability is not imposed for the benefit of the corporation, and is not in any sense a part of its assets, like unpaid subscriptions for stock, and cannot be enforced by the corporation itself, by assessment or otherwise, even for the purpose of raising a fund for the payment of debts.²³⁷ In the absence of provision to such effect, the liability cannot be enforced by a trustee or receiver of the corporation in bankruptcy or in-

²³³ Bowden v. Johnson, 107 U. S. 251, 27 L. Ed. 386, 2 Sup. Ct. 246; Germania Nat. Bank of New Orleans v. Case, 99 U. S. 628, 25 L. Ed. 448; Anderson v. Philadelphia Warehouse Co., 111 U. S. 479, 28 L. Ed. 478, 4 Sup. Ct. 525; National Carriage Mfg. Co. v. Story & Isham Commercial Co., 111 Cal. 531, 44 Pac. 157; Harrick v. Wardwell, 58 Ohio St. 294, 50 N. E. 903; Peter v. Union Mfg. Co., 56 Ohio St. 181, 46 N. E. 894; Burt v. Real Estate Exchange, 175 Pa. St. 619, 34 Atl. 924.

²³⁴ Foster v. Row, 120 Mich. 1, 79 N. W. 696, 77 Am. St. Rep. 565; Sykes v. Holloway, 81 Fed. 432; Miller v. Great Republic Ins. Co., 50 Mo. 55; Magruder v. Colston, 44 Md. 349, 22 Am. Rep. 47. See Fowler v. Crouse, 175 Fed. 646; Fremont State

Bank v. Vincent, 112 Wash. 493, 192 Pac. 975.

²³⁵ Mann's Case, 3 Ch. App. 459, note; Capper's Case, 3 Ch. App. 458; Foster v. Lincoln's Ex'r, 79 Fed. 170.

²³⁶ Harper v. Carroll, 66 Minn. 487, 69 N. W. 610, 1069; Lebens v. Nelson, 148 Minn. 240, 181 N. W. 350.

²³⁷ Selig v. Hamilton, 234 U. S. 652, 58 L. Ed. 1518, 34 Sup. Ct. 926, Ann. Cas. 1917 A 104; Umsted v. Buskirk, 17 Ohio St. 113; Wright v. McCormack, 17 Ohio St. 86; Colton v. Mayer, 90 Md. 711, 47 L. R. A. 617, 78 Am. St. Rep. 456, 45 Atl. 874; First Nat. Bank of Barre v. Hingham Mfg. Co., 127 Mass. 563; Northwestern Trust Co. v. Bradbury, 117 Minn. 83, 134 N. W. 513, Ann. Cas. 1913 D 69.

solvency, as the statutory liability and also liability upon bonus or watered stock are for creditors, and do not constitute a corporate asset. The trustee in bankruptcy cannot assert the liability as a successor to the property of the bankrupt nor as a representative of his creditors.²³⁸ A receiver appointed by a court of equity even if he is a general receiver invested with "all the estate, property, and equitable interests" of the corporation, cannot enforce the double liability of stockholders.²³⁹

Of course, special statutory provisions may change this rule. Statutes making stockholders individually liable for corporate debts may in express terms provide for the enforcement of the liability by a receiver of the corporation; and it may be enforced by a receiver, like the liability of stockholders on unpaid subscriptions, when it is placed on the same footing as unpaid subscriptions by being expressly or impliedly made or declared a part of the assets of the corporation, to be collected for the benefit of all the creditors ratably.²⁴⁰

Waiver of liability of stockholders.—A corporate creditor may agree to waive his claim to collect from stockholders debts which the corporation fails to pay. It is very common to include a "no recourse" clause in bonds and in the accompanying mortgage or trust deed. Even when this waiver of the right to enforce a statutory liability is inserted only in the mortgage and not in the

²³⁸ *Dutcher v. Marine Nat. Bank*, 12 Blatchf. 435, Fed. Cas. No. 4,203; *Jacobson v. Allen*, 20 Blatchf. 525, 12 Fed. 454. See *State Bank of Commerce v. Kenney Band Instrument Co.*, 143 Minn. 236, 173 N. W. 560; *Joseph T. Ryerson & Son v. Peden*, 303 Ill. 171, 135 N. E. 423, 24 A. L. R. 1273. Compare, *Grand Rapids Trust Co. v. Nichols*, 199 Mich. 126, 165 N. W. 667.

²³⁹ *Jacobson v. Allen*, 20 Blatchf. 525, 12 Fed. 454; *Colton v. Mayer*, 90 Md. 711, 45 Atl. 874, 47 L. R. A. 617, 78 Am. St. Rep. 456; *Lane v. Morris*, 8 Ga. 468; *Wincock v. Turpin*, 96 Ill. 135; *McLaughlin v. Kimball*, 20 Utah 254, 58 Pac. 685, 77 Am. St. Rep. 908; *Cuykendall v. Corning*, 88 N. Y. 129; *Hirshfeld v. Fitzgerald*, 157 N. Y. 166, 51 N. E. 997, 46 L. R. A. 839; *Hancock Nat. Bank*

v. Ellis, 166 Mass. 414, 44 N. E. 349, 55 Am. St. Rep. 414; s. c., 172 Mass. 39, 51 N. E. 207, 42 L. R. A. 396, 70 Am. St. Rep. 232; *Minneapolis Baseball Co. v. City Bank*, 66 Minn. 441, 69 N. W. 331, 38 L. R. A. 415.

²⁴⁰ *Zieverink v. Kemper*, 50 Ohio St. 208, 34 N. E. 250; *State ex rel. Stone v. Union Stock Yards State Bank*, 103 Iowa 549, 70 N. W. 752, 72 N. W. 1076; *Wilson v. Book*, 13 Wash. 676, 43 Pac. 939; *Howarth v. Lombard*, 175 Mass. 570, 56 N. E. 888, 49 L. R. A. 301; *Anderson v. Seymour*, 70 Minn. 358, 73 N. W. 171; *Brown v. Brink*, 57 Neb. 606, 78 N. W. 280; *Story v. Furman*, 25 N. Y. 214; *Selig v. Hamilton*, 234 U. S. 652, 58 L. Ed. 1518, 34 Sup. Ct. 926, Ann. Cas. 1917 A 104; *Bernheimer v. Converse*, 206 U. S. 516, 51 L. Ed. 1163, 27 Sup. Ct. 755.

bond itself, its validity has been upheld.²⁴¹ In a Minnesota case, however, a "no recourse" clause was construed as not intended to cover a fraud liability on watered stock.²⁴²

§ 224. Mode of enforcing the individual liability of stockholders.

Difficulty has been experienced in determining the mode in which the statutory liability of stockholders must be enforced, and the decisions on the question are to some extent conflicting. The question, of course, depends primarily upon the terms of the particular statute. It is well settled that if the statute creating the liability expressly provides a remedy for enforcing the same, this remedy is exclusive, and must be followed, unless there is something to show that the legislature did not intend to make the remedy exclusive.²⁴³ If the statute provides that the liability shall be enforced in equity, and does not authorize an action at law, or if it appears from the whole statute that it was the intention of the legislature to provide a common fund, like the fund realized from unpaid subscriptions, for the benefit of all the creditors ratably, so that the purpose of the statute would be defeated if a single creditor were permitted to maintain an action at law against a stockholder to enforce his claim to the extent of the stockholder's liability, and thus "appropriate to himself, without regard to the rights of others, that which is to make up the fund";²⁴⁴ or if the nature of the liability is such that it is necessary to take an account of stock and debts for the purpose of determining the extent of each stockholder's liability,—in these cases the remedy to enforce the liability of the stockholders is in equity, and actions at law cannot be maintained by creditors.²⁴⁵

²⁴¹ *Babbitt v. Read*, 236 Fed. 42; *Marfield v. Cincinnati, D. & T. Traction Co.*, 111 Ohio St. 139, 144 N. E. 689, noted 23 Michigan Law Rev. 293; 40 A. L. R. 357, 371, note on validity of stipulation waiving liability of stockholders.

²⁴² *Downer v. Union Land Co.*, 113 Minn. 410, 129 N. W. 777.

²⁴³ *Pollard v. Bailey*, 20 Wall. (U. S.) 520, 526, 527, 22 L. Ed. 376; *Fourth Nat. Bank of New York v. Francklyn*, 120 U. S. 747, 30 L. Ed. 825, 7 Sup. Ct. 757; *Russell v. Pacific Ry. Co.*, 113 Cal. 258, 45 Pac. 323, 34 L. R. A. 747; *Fowler v. Lamson*, 146 Ill. 472, 34 N. E. 932, 37 Am. St.

Rep. 163; *Woodworth v. Bowles*, 61 Kan. 569, 60 Pac. 331; *E. Remington & Sons v. Samana Bay Co.*, 140 Mass. 494, 5 N. E. 292; *Lowry v. Inman*, 46 N. Y. 119; *Northwestern Trust Co. v. Bradbury*, 117 Minn. 83, 134 N. W. 513, Ann. Cas. 1913 D 69.

²⁴⁴ *Terry v. Little*, 101 U. S. 216, 25 L. Ed. 864.

²⁴⁵ *Pollard v. Bailey*, 20 Wall. (U. S.) 520, 22 L. Ed. 376; *Terry v. Little*, 101 U. S. 216, 25 L. Ed. 864; *Zang v. Wyant*, 25 Colo. 551, 56 Pac. 565, 71 Am. St. Rep. 145; *Harris v. First Parish in Dorchester*, 23 Pick. (Mass.) 112; *Harper v. Carroll*, 66 Minn. 487, 69 N. W. 610, 1069:

Some of the courts have held that a statute making stockholders individually liable for the debts of the corporation to the extent of their stock, or in proportion to the amount of their stock, imposes a liability which any creditor may enforce against any stockholder to the extent of his liability,²⁴⁶ while other courts have held that such a statute is intended to create a common fund for the benefit of all the creditors ratably, and that the liability can only be enforced by a bill in equity on behalf of all the creditors, in which all the stockholders who can be reached may be compelled to pay in so much as may be necessary, not exceeding the extent of their liability, and the fund so realized distributed *pro rata* among the creditors. This is the prevailing view.²⁴⁷

It has been pointed out that there are three general systems or methods of enforcing statutory liability.²⁴⁸ The crudest system permits any creditor to proceed against any stockholder, sometimes with and sometimes without exhausting legal remedies against the corporation by return of execution unsatisfied. This is unsatisfactory, as it apportions the burden unequally between large and small stockholders. The next system allowed the creditors to file a bill in equity against the corporation and all the alleged stockholders in which the unpaid balance of the corporate indebtedness was ascertained and apportioned among the various stockholders in proportion to their holdings. This statutory remedy in equity was held to be exclusive and could not be given outside the state of creation of the corporation. Thus the whole burden was cast on domestic stockholders.

To meet these difficulties the assessment system was evolved, following the model provided by the National Banking Act. By the assessment system the equitable action of the second system is

Northwestern Trust Co. v. Bradbury, 117 Minn. 83, 134 N. W. 513, Ann. Cas. 1913 D 69; *Hirshfeld v. Fitzgerald*, 157 N. Y. 166, 51 N. E. 997, 46 L. R. A. 839; *Marshall v. Sherman*, 148 N. Y. 9, 42 N. E. 419, 34 L. R. A. 757, 51 Am. St. Rep. 654; *Umsted v. Buskirk*, 17 Ohio St. 113; *Barrick v. Gifford*, 47 Ohio St. 180, 24 N. E. 259, 21 Am. St. Rep. 798; *Parker v. Carolina Sav. Bank*, 53 S. C. 583, 31 S. E. 673, 69 Am. St. Rep. 888; *Coleman v. White*, 14 Wis. 700, 80 Am. Dec. 797; *Barton Nat. Bank v. Atkins*, 72 Vt. 33, 47 Atl. 176.

²⁴⁶ *Bank of Poughkeepsie v. Ibbotson*, 24 Wend. (N. Y.) 473; *Larrabee*

v. Baldwin, 35 Cal. 155; *Lane v. Harris*, 16 Ga. 217.

²⁴⁷ *Pollard v. Bailey*, 20 Wall. (U. S.) 520, 22 L. Ed. 376; *Terry v. Little*, 101 U. S. 216, 25 L. Ed. 864; *Harris v. First Parish in Dorchester*, 23 Pick. (Mass.) 112; *Coleman v. White*, 14 Wis. 700, 80 Am. Dec. 797; *Jones v. Jarman*, 34 Ark. 323; *Bottlers' Seal Co. v. Rainey*, 243 N. Y. 333, 153 N. E. 437. See 27 Columbia Law Rev. 97.

²⁴⁸ *E. H. Abbot, Jr.*, Conflict of laws and the enforcement of the statutory liability of stockholders in a foreign corporation, 23 Harvard Law Rev. 37.

split into two parts, one in equity against the corporation, the other at law against the stockholders individually. In the first, the excess of corporate debts over corporate assets is established and the amount of outstanding stock ascertained. A sufficient assessment is then levied on each share to meet the debit balance. The assessment in the proceeding against the corporation fixes the rate of liability. The collection of the amounts due from individual stockholders is enforced in single actions at law brought against each shareholder individually, in which the defendant may bring forward any personal defense, but may not attack the necessity for or the extent of the assessment. Thus by the assessment system a uniform rate of burden per share is established for all stockholders and the personal liability of each shareholder may be fixed in a subsequent action at law in any jurisdiction where the defendant may be found.

The Minnesota statutes provide the assessment method for the enforcement of its constitutional double liability, upon a petition by a receiver or assignee of a corporation or of any creditors. The statute provides for due notice by publication or otherwise, for a general inquiry into the question whether the available assets will be sufficient to pay the expenses of the proceedings and the indebtedness in full and without delay and for a ratable assessment upon all parties liable as stockholders for such amount or percentage of such liability upon each share of stock as it shall deem proper. The order is to authorize and direct the assignee or receiver to collect the amount so assessed and upon failure of payment by any stockholders to prosecute an action against them whether resident or nonresident and wherever found.²⁴⁹

Proceedings under the Minnesota statutes for an assessment against the stockholders of an insolvent corporation are summary and informal. The statute provides that the Court shall consider evidence bearing upon the following points: (1) The nature and probable extent of the indebtedness of the corporation; (2) the probable expense of the receivership; (3) the probable amount of available assets; and (4) the persons liable as stockholders, the

²⁴⁹ Enforcement of Minnesota statutory double liability is by a pro rata assessment levied by the court in sequestration proceedings or in a creditor's suit, to be collected in suits against the stockholders. *Finch, Van Slyck & McConville v. Vanasek*, 132 Minn. 9, 155 N. W. 754; *Dispatch*

Printing Co. v. Security Bond & Investment Co., 154 Minn. 211, 191 N. W. 601 (an assessment is not a necessary or proper preliminary to a creditor's bill against holders of bonus stock on the ground of fraud or inadequate payment). See also, *Fletcher, Corporations*, sec. 4223.

nature and extent of their liability, and their probable solvency and responsibility; and therefrom determine the propriety and necessity of the proposed assessment. The question is to be determined in such case by the probability. The assessment is but the foundation for the proceedings subsequently to be brought for collection if voluntary payment be not made. If a surplus remains after payment of debts and expenses it is returned to the stockholders.²⁵⁰

The order of assessment is made conclusive upon all of the stockholders as to all matters relating to the amount, propriety and necessity of the assessment. No person is deprived by the finding however, of opportunity of showing that he is not a stockholder, or that he holds less stock than found, or that he has a set-off available or has any other defense personal to himself. It is the duty of the courts of other states under the due faith and credit clause to give effect to the orders of the Minnesota courts in making assessments on stockholders, although the stockholders were not personally made parties to the suits in which the orders were made.²⁵¹ The receiver, as representative of the creditors may sue in aid of the parent proceeding in another state. As is said in *Converse v. Hamilton*:²⁵²

“Under this statute, as interpreted by the Supreme Court of the State, as also by this court, the receiver is not an ordinary chancery receiver or arm of the court appointing him, but a quasi-assignee and representative of the creditors, and when the order levying the assessment is made he becomes invested with the creditors’ rights of action against the stockholders and with full authority to enforce the same in any court of competent jurisdiction in the state or elsewhere.”

²⁵⁰ *Straw & Ellsworth Mfg. Co. v. L. D. Kilbourne Boot & Shoe Co.*, 80 Minn. 125, 83 N. W. 36; *Finch, Van Slyck & McConville v. Vanasek*, 132 Minn. 9, 155 N. W. 754.

It is said that the proceeding is not materially different from that authorized by the National Bank Act, except that under the latter the assessment is made by the comptroller of the currency, while here the assessment is made by the court. *Straw & Ellsworth Mfg. Co. v. L. D. Kilbourne Boot & Shoe Co.*, *supra*.

²⁵¹ *Bernheimer v. Converse*, 206 U. S. 516, 528, 51 L. Ed. 1163, 27 Sup. Ct. 755; *Converse v. Hamilton*, 224

U. S. 243, 56 L. Ed. 749, 32 Sup. Ct. 415, Ann. Cas. 1913 D 1292; *Selig v. Hamilton*, 234 U. S. 652, 58 L. Ed. 1518, 34 Sup. Ct. 926, Ann. Cas. 1917 A 104; *Marin v. Augedahl*, 247 U. S. 142, 62 L. Ed. 1038, 38 Sup. Ct. 452. See 27 *Columbia Law Rev.* 96.

²⁵² 224 U. S. 243, 56 L. Ed. 749, 32 Sup. Ct. 415, Ann. Cas. 1913 D 1292. See also, *Britton v. Andrews*, 8 Fed. (2d) 950, 954. Actions at law by receiver against the various subscribers necessary, after the assessment has been made against the subscribers for the proportional amount needed.

Statute of limitations.—The double liability of stockholders of national banks is conditional, and the right to sue does not arise until the Comptroller of the Currency has acted; his order is the basis of the suit and the statute of limitations does not commence to run until assessment is made. Then it runs as against an action to enforce a statutory liability and not an action for breach of contract. In the absence of act of Congress fixing limitation of time to enforce liability of stockholders in national banks, the statute of the particular state is applicable.²⁵³ Under the California statute the strange doctrine prevails that time begins to run when the liability is originally created, that is from the date of the original contract or promise and not when it matures or becomes payable.²⁵⁴ Since the period of limitation is three years any obligation which runs for more than that time escapes stockholder's liability.

²⁵³ *McClaine v. Rankin*, 197 U. S. 154, 49 L. Ed. 702, 25 Sup. Ct. 410, 3 Ann. Cas. 500; *Miller v. Hammer*, 269 Fed. 891, 895; *Warner v. Citizens' Nat. Bank*, 267 Fed. 661, 663.

²⁵⁴ *Hunt v. Ward*, 99 Cal. 612, 34 Pac. 335, 37 Am. St. Rep. 60; *Winona Wagon Co. v. Bull*, 108 Cal. 1, 40 Pac. 1077; *Chambers v. Farnham*, 182 Cal. 191, 187 Pac. 732.

CHAPTER XVIII.

RIGHTS AND REMEDIES OF CREDITORS OF CORPORATIONS.

§ 225. Capital stock and assets of a corporation as a trust fund for creditors. If the capital of a corporation can be said to be a trust fund in any sense, it is only that it cannot be distributed among or withdrawn by the stockholders, or conveyed or given away without consideration, leaving creditors unpaid, and in the sense that, when the corporation has been dissolved or gone into the hands of a receiver, its assets will be distributed, subject to valid liens thereon, for the equal benefit of all the creditors.

In what sense is the capital stock of a corporation a trust fund for creditors?

It has repeatedly been said that the assets of a corporation representing its capital stock, constitute a trust fund for the benefit of its creditors. This is the explanation given for various rules which may often be explained on better grounds. It is referred to in connection with the rule that stockholders may be compelled in equity, at the suit of creditors, to pay in the full amount of their stock; that creditors may follow and subject to the payment of their claims assets wrongfully distributed among or withdrawn by the stockholders, or paid or conveyed to third persons without consideration; and that, when the corporation becomes insolvent, particular creditors cannot be given or obtain any preference, by way of payment or security, over other creditors.¹

¹ Wood v. Dummer, 3 Mason, 308, Fed. Cas. No. 17, 944; Sawyer v. Hoag, 17 Wall. (U. S.) 610, 21 L. Ed. 731; Curran v. State v. Arkansas, 15 How. (U. S.) 304, 14 L. Ed. 705; Sanger v. Upton, 91 U. S. 56, 23 L. Ed. 220; Hatch v. Dana, 101 U. S. 205, 25 L. Ed. 885; Buck v. Ross, 68 Conn. 29, 35 Atl. 763, 57 Am. St. Rep. 60; Clapp v. Peterson, 104 Ill. 26; Singer v. Hutchinson, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133; State v. Commercial State Bank, 28 Neb. 677, 44 N. W. 998; Cole v. Mil-

lerton Iron Co., 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; Trotter v. Lisman, 209 N. Y. 174, 102 N. E. 575; Rouse v. Merchants' Nat. Bank, 46 Ohio St. 493, 22 N. E. 295, 5 L. R. A. 398, 15 Am. St. Rep. 644; Conover v. Hull, 10 Wash. 673, 39 Pac. 166, 45 Am. St. Rep. 810; Cook v. Moody, 18 Wash. 114, 50 Pac. 1020, 63 Am. St. Rep. 872; Pomeroy, Equity Juris. § 1046. See Warren, Safeguarding the creditors of corporations, 36 Harvard Law Rev. 509, 546.

This doctrine, called the "trust-fund doctrine," was definitely announced for the first time by Mr. Justice Story in 1824. A banking corporation had distributed the greater part of its capital among its stockholders as dividends, leaving little or nothing for the payment of holders of its bills and other creditors, and the latter brought suit in equity to hold the stockholders liable. Mr. Justice Story, in holding the stockholders liable to the extent of the assets thus received by them, based his decision on the ground that the assets of the bank representing its capital stock were a "pledge or trust fund" for the payment of its debts, and for this reason might "be followed by the creditors into the hands of any persons having notice of the trust attaching to it."²

It is very obvious that Mr. Justice Story went beyond the necessities of this case in basing his decision on the ground that the assets of the bank constituted a trust fund for creditors. The corporation, while it was indebted, had distributed funds representing its capital stock among the stockholders, without any consideration, leaving its creditors unpaid. The decision, therefore, might well have been based, not upon the ground that the capital stock, or the money or property representing the same, was in any sense a trust fund for the benefit of creditors, but upon the ground that the distribution of the assets among the stockholders was a fraud upon creditors; and this is true of many other cases in which the trust-fund doctrine has been announced. The later cases, not only in most of the state courts, but also in the federal courts, have repudiated or limited the theory.³ It is not true,

Capital stock is a trust fund which cannot be withdrawn to prejudice of creditors. *Williams v. Brownstein*, 1 Fed. (2d) 470 (purchase of own stock is in fraud of subsequent creditors); *Linden Bros. v. Practical Elec. & Eng. Pub. Co.*, 309 Ill. 132, 140 N. E. 874; *Scott v. Barton*, 285 Mo. 427, 226 S. W. 958 (bonus stock); *Miller v. Griswold Bldg. Co.*, 217 Mich. 192, 185 N. W. 677.

² *Wood v. Dummer*, 3 Mason 308, Fed. Cas. No. 17,944:

"The charter relieves them (the individual stockholders) from personal responsibility and substitutes the capital stock in its stead. . . . The bill holders and other creditors have the first claims upon it, and the stockholders have no rights, until all the other creditors are satisfied."

³ *Ratcliff v. Clendenin*, 232 Fed. 61, 66 (trust attaches only when corporation becomes insolvent); *Graham v. La Crosse & M. R. Co.*, 102 U. S. 148, 26 L. Ed. 106; *Sweet v. Lang*, 14 Fed. (2d) 762, 766; *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 37 L. Ed. 1113, 14 Sup. Ct. 127; *Coit v. North Carolina Gold Amalgamating Co.*, 119 U. S. 343, 30 L. Ed. 420, 7 Sup. Ct. 231; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227, 11 Sup. Ct. 530; *McDonald v. Williams*, 174 U. S. 397, 43 L. Ed. 1022, 19 Sup. Ct. 743; *O'Bear Jewelry Co. v. Volfer*, 106 Ala. 205, 17 So. 525, 28 L. R. A. 707, 54 Am. St. Rep. 31; *Worthen v. Griffith*, 59 Ark. 562, 28 S. W. 286, 43 Am. St. Rep. 50; *Catlin v. Eagle Bank of New Haven*, 6 Conn. 233; *Hospes v. Northwestern Mfg. & Car*

however, that the capital of a corporation is held just as a natural person holds his property.⁴

In the leading case of *Hollins v. Brierfield Coal & Iron Co.*,⁵ certain simple contract creditors of an insolvent corporation, not having reduced their claims to judgment, and not having any lien by mortgage, deed of trust, or otherwise, sued in equity to reach and subject to the payment of their claims property which had been conveyed by the corporation, and unpaid stock subscriptions, on the ground that the assets of the corporation constituted a trust fund for creditors, and that, whenever a creditor has a trust in his favor, or a lien upon property for a debt due him, he may go into equity without exhausting his legal remedies. The court held, however, that simple contract creditors cannot come into equity to obtain seizure of the property of their debtor, as if they were beneficiaries of a trust fund entitled to have it administered by a court of equity.

A creditor of a corporation, although it may be insolvent, cannot sue in equity to enjoin it from making an improvident contract or conveyance, or otherwise interfere in its management, where no fraud or breach of trust is alleged.⁶ In most jurisdictions also the mere insolvency of a corporation does not render its assets in its hands a trust fund for the benefit of creditors in such a sense as to prevent it from giving a preference to one or more of its creditors to the exclusion of others.⁷ It has also been held that a conveyance by a corporation without consideration cannot, any

Co., 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637; *First Nat. Bank of Deadwood v. Gustin Minerva Consol. Min. Co.*, 42 Minn. 327, 44 N. W. 196, 6 L. R. A. 676, 18 Am. St. Rep. 510; *Schufeldt v. Smith*, 131 Mo. 280, 31 S. W. 1039, 29 L. R. A. 830, 52 Am. St. Rep. 628; dissenting opinion of Kellam, J., in *Adams & Westlake Co. v. Deyette*, 8 S. D. 119, 65 N. W. 471, 31 L. R. A. 497, 59 Am. St. Rep. 751.

⁴ "A corporation in dealing with its capital has not the same freedom of action that a solvent individual would have in dealing with his assets; it must, in obedience to the legislative intent, consider its creditors, present and future, in dealing with the assets which constitute its capital." E. H. Warren, 34 *Harvard Law Rev.* 294.

⁵ 150 U. S. 371, 37 L. Ed. 1113, 14 Sup. Ct. 127. See *Pierce v. United States*, 255 U. S. 393, 403, 65 L. Ed. 697, 703, 41 Sup. Ct. 365 (a bill to reach and apply assets of the corporation cannot be filed until the claim has been reduced to judgment and execution returned unsatisfied). *Porter v. Rott*, 116 Okla. 3, 243 Pac. 160, 164; *Fletcher, Corporations*, vol. 8, pp. 8640, 8644; vol. 5, sec. 3206.

⁶ *Pond v. Framingham & Lowell R. Co.*, 130 Mass. 194. And see post, § 227; *Gay v. Hudson River Elec. Power Co.*, 137 Fed. 12; *Mills v. Northern Ry. of B. A. Co.*, L. R. 5 Ch. App. 621.

⁷ *O'Bear Jewelry Co. v. Volfer*, 106 Ala. 205, 17 So. 525, 28 L. R. A. 707, 54 Am. St. Rep. 31. See post, § 232.

more than a conveyance by a natural person, be attacked by a subsequent creditor. Such a creditor cannot maintain a bill to set aside a sale of corporate property by directors to themselves, there being no actual fraud, and the corporation being solvent at the time. The principle of the cases is that subsequent creditors cannot question a voluntary or fraudulent disposition of property by their debtor not intended as a fraud against them.⁸

§ 226. Execution or attachment against corporations.—Creditors cannot reach by execution or attachment the franchises of the corporation, or, in the case of a quasi public corporation, any property which is essential to enable it to exercise its franchises and perform its duties to the public.

Property subject to execution or attachment.—The secondary franchises of a corporation cannot be taken on execution or attachment unless it is authorized by statute, because, in the first place, they are intangible, and, in the second place, they cannot be transferred without the consent of the state which granted them.⁹ But authority to sell the franchises of a corporation to satisfy a judgment is expressly given by statute in some jurisdictions. There are also limitations to the right to take and sell the tangible property of *quasi* public corporations on execution or attachment, just as there are limitations to the right of such corporations to sell their property. When a corporation, such as a railroad company, canal or turnpike company, water or gas company, or other *quasi* public corporation, is charged with public duties, and is in the exercise of its franchises and the performance of such duties, a judgment creditor cannot levy upon and sell any of its property which has been dedicated by it to corporate purposes, and which is essential to enable it to exercise its franchises and perform its duties to the

⁸ *Graham v. La Crosse & M. R. Co.*, 102 U. S. 148, 26 L. Ed. 106; *Hamilton v. Menominee Falls Quarry Co.*, 106 Wis. 352, 81 N. W. 876. But see *Mackall v. Pocock*, 136 Minn. 8, 161 N. W. 228, L. R. A. 1917 C 390; *Fletcher, Corporations*, sec. 5051.

⁹ *Gue v. Tide Water Canal Co.*, 24 How. (U. S.) 257, 16 L. Ed. 635; *City of Palestine v. Barnes*, 50 Tex. 538; *Ammant v. New Alexandria &*

P. Turnpike Road, 13 Serg. & R. (Pa.) 210, 15 Am. Dec. 593; *Susquehanna Canal Co. v. Bonham*, 9 Watts & S. (Pa.) 27, 42 Am. Dec. 315; *State v. Turnpike Co. of Middletown*, 65 N. J. Law 73, 46 Atl. 569; *Eldridge v. Mill Ditch Co.*, 90 Ore. 590, 595, 177 Pac. 939 (refusing to allow execution upon ditch and water-rights of a mutual water company).

public, unless the right to do so is expressly given by statute; and it is immaterial whether the property was acquired under the power of eminent domain, or by purchase or donation.¹⁰

The only remedy of the judgment creditor in such cases, in the absence of a statute, is to obtain the appointment of a receiver and a sequestration of the company's income and earnings. This doctrine has been applied, for example, to the locks, wharf, houses, and land of a canal company, used and necessary in the operation of the canal;¹¹ to the land and buildings owned and actually used by a railroad company in the operation of its railroad,¹² and to the bridge of a toll-bridge company.¹³

The doctrine exempting property of *quasi* public corporations from execution and attachment is based upon the ground that the interests of the public are involved, and are paramount to the rights of creditors, and it does not apply so as to exempt the property of a purely private corporation, as a manufacturing company, for example, which owes no duties to the public.¹⁴ Nor does it exempt property belonging to a railroad company or other *quasi* public corporation, which is not in use by it, or which, although in use, is not necessary to enable it to exercise its franchises and perform its duties to the public.¹⁵ Thus it has been held that the rule does not apply to land or town lots owned by a railroad company, but not dedicated to or necessary in the operation of its road;¹⁶ or to steel rails purchased, but not used, and not needed for present use.¹⁷ And, by the weight of authority, the rule does not apply

¹⁰ *Gue v. Tide Water Canal Co.*, 24 How. (U. S.) 257, 16 L. Ed. 635; *Overton Bridge Co. v. Means*, 33 Neb. 857, 51 N. W. 240, 29 Am. St. Rep. 514; *State v. Turnpike Co. of Middletown*, 65 N. J. Law 73, 46 Atl. 569; *Gooch v. McGee*, 83 N. C. 59, 35 Am. Rep. 558; *Johnson Co. v. Miller*, 174 Pa. St. 605, 34 Atl. 316, 52 Am. St. Rep. 833.

¹¹ *Gue v. Tide Water Canal Co.*, 24 How. (U. S.) 257, 16 L. Ed. 635.

¹² *Plymouth R. Co. v. Colwell*, 39 Pa. St. 337, 80 Am. Dec. 526; *McColgan v. Baltimore Belt R. Co.*, 85 Md. 519, 36 Atl. 1026; *East Alabama Ry. Co. v. Doe*, 114 U. S. 340, 29 L. Ed. 136, 5 Sup. Ct. 869; *McNulty Bros. Co. v. Pennsylvania R. Co.*, 272 Pa. 442, 116 Atl. 362. See *Gardner v. Mobile & N. W. R. Co.*, 102 Ala. 635, 15 So. 271, 48 Am. St. Rep. 84.

¹³ *Overton Bridge Co. v. Means*, 33 Neb. 857, 51 N. W. 240, 29 Am. St. Rep. 514.

¹⁴ *Reynolds v. Reynolds Lumber Co.*, 169 Pa. St. 626, 32 Atl. 537, 47 Am. St. Rep. 935.

¹⁵ *Plymouth R. Co. v. Colwell*, 39 Pa. St. 337, 80 Am. Dec. 526; *Johnson Co. v. Miller*, 174 Pa. St. 605, 34 Atl. 316, 52 Am. St. Rep. 833; *Reynolds v. Reynolds Lumber Co.*, 169 Pa. St. 626, 32 Atl. 537, 47 Am. St. Rep. 935; *Gardner v. Mobile & N. W. R. Co.*, 102 Ala. 635, 15 So. 271, 48 Am. St. Rep. 84.

¹⁶ *Plymouth R. Co. v. Colwell*, 39 Pa. St. 337, 80 Am. Dec. 526.

¹⁷ *Johnson Co. v. Miller*, 174 Pa. St. 605, 34 Atl. 316, 52 Am. St. Rep. 833.

to the cars or other rolling stock of a railroad company, unless it is in actual use at the time of the levy,¹⁸ nor to the safe and other movables of such a corporation.¹⁹

§ 227. Right of creditors to bring suit in reference to the management of the corporation.—Unless authorized by statute, a general creditor of a corporation cannot, by a bill in equity for an injunction and receiver, or otherwise, interfere with the management of the corporation, whether it is solvent or insolvent, by preventing it from making contracts, creating debts, or disposing of its property, etc., whether the acts complained of are *intra vires* or *ultra vires*, unless he alleges and shows some fraud or breach of trust as against him, or the violation of some lien or other special right which he has acquired, and the enforcement or protection of which is within the jurisdiction of the court.

A creditor cannot come into a court of equity and enjoin the corporation from making contracts or conveyances, or otherwise interfere with the management of its affairs, unless he can show, as ground for the relief sought, some fraud or breach of trust as against him, or the violation of some special right which he has acquired by contract with the corporation. The only remedy of the creditor, in the absence of a statute, if he thinks that the corporation is being so managed as to waste its assets and render his claim uncollectible, is to obtain security by means of an attachment or execution, if the circumstances are such as to permit this course. He cannot interfere by injunction merely on the ground that the corporation is insolvent, and that its contemplated action may render his claim uncollectible, nor on the ground that the contemplated action is *ultra vires*.²⁰

¹⁸ Davis v. Cleveland, C., C. & St. L. R. Co., 217 U. S. 157, 54 L. Ed. 708, 30 Sup. Ct. 463, 27 L. R. A. (N. S.) 823, 18 Ann. Cas. 907; Boston, C. & M. R. Co. v. Gilmore, 37 N. H. 410, 72 Am. Dec. 336; Coe v. Columbus, P. & I. R. Co., 10 Ohio St. 372, 75 Am. Dec. 518; Risdon Iron & Locomotive Works v. Citizens' Traction Co. of San Diego, 122 Cal. 94, 54 Pac. 529, 68 Am. St. Rep. 25; Hoyle v. Plattsburgh & M. R. Co., 54 N. Y. 314, 13 Am. Rep. 595; Randall v. Elwell, 52 N. Y. 521, 11 Am. Rep. 747. Contra, Covey v. Pittsburg, Ft. Wayne & C. R. Co., 3 Phila. (Pa.) 173. See Central Trust Co. of New York v. Moran, 56 Minn. 188, 57 N.

W. 471, 29 L. R. A. 212 (mortgagees may enjoin levy on mortgaged rolling stock); Margo v. Pennsylvania R. Co., 213 Pa. 468, 62 Atl. 1081, 110 Am. St. Rep. 559, 5 Ann. Cas. 511. Railroad ties, rails, etc., kept in stock for emergency being necessary to enable the company to perform its duties to the public are exempt on grounds of public policy from levy and sale on execution.

¹⁹ Risdon Iron & Locomotive Works v. Citizens' Traction Co. of San Diego, 122 Cal. 94, 54 Pac. 529, 68 Am. St. Rep. 25.

²⁰ Pond v. Framingham & Lowell R. Co., 130 Mass. 194; Mills v. Northern Railway of Buenos Ayres Co., 5

It has been held, therefore, that general creditors of a railroad company cannot maintain a bill to enjoin it from making an improvident lease for a long term of years, although it is alleged that the corporation is insolvent, where there is no allegation of fraud or breach of trust, or any other ground of equity jurisdiction bringing the case within the general equity powers of a court of chancery.²¹ The creditors of a company cannot sue in equity to enjoin the company from *ultra vires* acts, such as increasing its liabilities by the issue of debenture stock, for the purpose of borrowing money, and distributing the same among its shareholders under the guise of revenue and as dividends.²² Creditors cannot attack a transaction by the officers of a corporation in which they have an interest adverse to that of the corporation, regardless of its fairness or unfairness, merely on the ground that it is voidable at the instance of the corporation or the stockholders, but, in order that they may impeach it, they must show fraud as against themselves, either because the corporation was insolvent at the time of the transaction, or because the transaction was entered into with intent to hinder, delay, or defraud them.²³

Where creditors of a corporation, however, have, under their contract with it, a specific lien on its property, or a right to a part of its assets on the happening of a future contingency, they may sue in equity to enjoin a transfer or waste of the assets, in violation of their contracts, whereby they will sustain irreparable injury.²⁴

Ch. App. 621; *Cleveland City Forge Iron Co. v. Taylor Bros. Iron-Works Co.*, 54 Fed. 85; *O'Conner Min. & Mfg. Co. v. Coosa Furnace Co.*, 95 Ala. 614, 10 So. 290, 36 Am. St. Rep. 251; *Fort Payne Furnace Co. v. Fort Payne Coal & Iron Co.*, 96 Ala. 472, 11 So. 439, 38 Am. St. Rep. 109; *Brent v. Simpson*, 238 Fed. 285, 291; *Force v. Age-Herald Co.*, 136 Ala. 271, 33 So. 866. A creditor cannot attack a corporate transaction merely on the ground of *ultra vires*. He can only attack it on the ground that its effect is to divert the corporate assets from the payment of his debt.

²¹ *Pond v. Framingham & Lowell R. Co.*, 130 Mass. 194; *Gay v. Hudson River Elec. Power Co.*, 187 Fed. 12.

²² *Mills v. Northern Railway of Buenos Ayres Co.*, 5 Ch. App. 621.

The remedy for an unsecured creditor is to obtain his judgment and take out execution. He cannot re-

strain the company from doing an *ultra vires* act in borrowing money to pay a dividend to the shareholders, in order to keep the assets intact for the payment of his debt. See *Force v. Age-Herald Co.*, 136 Ala. 271, 33 So. 866; *Gullege v. Woods*, 108 Miss. 233, 66 So. 536; *Lincoln Court Realty Co. v. Kentucky Title, Sav. Bank & Trust Co.*, 169 Ky. 840, 185 S. W. 156; *Brent v. Simpson*, 238 Fed. 285, 291.

²³ *O'Conner Min. & Mfg. Co. v. Coosa Furnace Co.*, 95 Ala. 614, 10 So. 290, 36 Am. St. Rep. 251; *Welch v. Importers' & Traders' Nat. Bank*, 122 N. Y. 177, 25 N. E. 269. See *Graham v. La Crosse & M. R. Co.*, 102 U. S. 148, 26 L. Ed. 106.

²⁴ *Kearns v. Leaf*, 1 Hem. & M. 681; *Foster v. Borax Co.*, 80 Law T. (N. S.) 461; *Lothrop v. Stedman*, 13 Blatchf. 134, 141, 42 Conn. 583, Fed. Cas. No. 8519. See also, *Conro v. Gray*, 4 How. Pr. (N. Y.) 166.

§ 228. Creditors' bills in equity to reach assets.—Creditors of a corporation may maintain a creditors' bill in equity in a proper case to reach assets of the corporation, after having exhausted their remedies at law.

Independently of any statutory provision, a creditor of a corporation may maintain a creditors' bill in equity against it and other necessary or proper parties to reach resources and assets, and thereby obtain satisfaction of his debt, when he has exhausted his legal remedies, or when the circumstances are such that he has no legal remedy.²⁵ The principles governing such a suit are the same as where suit is brought against a natural person. Such a bill may be maintained, for example, to set aside a fraudulent conveyance, transfer, or mortgage by the corporation, and to subject the property to the payment of its debt, or to hold the grantees or transferees liable for the value of the property;²⁶ to enforce claims in favor of the corporation against the directors or other officers for misappropriation or diversion of assets, mismanagement or negligence,²⁷ to reach or hold stockholders liable for assets withdrawn by them, or distributed among them, in fraud of the rights of creditors;²⁸ or to enforce a liability of stockholders for a balance due on their stock.²⁹

Courts of equity entertain a creditor's bill, whether against a natural person or a corporation, on the ground that he has no adequate remedy at law, and as a general rule, therefore, in the absence of a statute,³⁰ a mere general creditor, who has not obtained a judgment, has no standing in equity to maintain a creditor's bill. He must have exhausted his legal remedies by recovering a judgment against the corporation, and issuing execution thereon,³¹ or else he must show that, because of dissolution, or for some other

²⁵ *Ogilvie v. Knox Ins. Co.*, 22 How. (U. S.) 380, 16 L. Ed. 349; *Hatch v. Dana*, 101 U. S. 205, 25 L. Ed. 885; *Parker v. Carolina Sav. Bank*, 53 S. C. 583, 31 S. E. 673, 69 Am. St. Rep. 888; *Olney v. Conanicut Land Co.*, 16 R. I. 597, 18 Atl. 181, 5 L. R. A. 361, 27 Am. St. Rep. 767; *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158. See *Pierce v. United States*, 255 U. S. 398, 65 L. Ed. 697, 41 Sup. Ct. 365.

²⁶ See the cases in note 25. And see post, § 229.

²⁷ Ante, § 120.

²⁸ Post, § 230. See also, *Williams v. Commercial Nat. Bank*, 49 Ore.

492, 90 Pac. 1012, 1015, 91 Pac. 443, 11 L. R. A. (N. S.) 857.

²⁹ Ante, § 199 et seq.

³⁰ See *Tradesman Pub. Co. v. Knoxville Car Wheel Co.*, 95 Tenn. 634, 32 S. W. 1097, 31 L. R. A. 593, 49 Am. St. Rep. 943; *Kemmler v. McGovern*, 238 Pa. 460, 86 Atl. 304.

³¹ *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 37 L. Ed. 1113, 14 Sup. Ct. 127; *Atlas Nat. Bank v. John Moran Packing Co.*, 138 Mo. 59, 39 S. W. 71; *Wehn v. Fall*, 55 Neb. 547, 76 N. W. 13, 70 Am. St. Rep. 397. See *Raymond v. Blancgrass*, 36 Mont. 449, 93 Pac. 648, 15 L. R. A. (N. S.) 976; *Porter v. Rott*, 116 Okla. 3, 243 Pac. 160, 164.

reason, he could not do so,³² or, if he could, that, by reason of insolvency or otherwise, it would have been useless. An objection that the plaintiff is only a simple contract creditor and not entitled to equitable relief without having reduced his claim to a judgment and exhausted his remedy at law is without merit where it appears that the company is totally insolvent and its property is in danger of loss. Equity will not require meaningless forms or useless proceedings at law.³³ It will not insist on recovery of judgment at law if the immediate action of a court of equity is necessary to protect him.³⁴

§ 229. Fraudulent conveyances or transfers by corporations.—A creditor of a corporation, after recovery of a judgment against it, and the return of an execution thereon unsatisfied, or under some circumstances without this, may maintain a suit in equity to reach and subject to the satisfaction of his claim property fraudulently transferred by the corporation.

If a corporation conveys or transfers its property, real or personal, to an individual or another corporation, with intent to hinder, delay, or defraud creditors, or without consideration, existing creditors may sue in equity, after exhausting their remedies at law, to set the conveyance or transfer aside as fraudulent, and to subject the property to the satisfaction of their claims, or to hold the grantee or transferee liable for its value.³⁵ In some jurisdictions, creditors may treat the conveyance or transfer as absolutely void, and levy an execution on the property as the property of the corporation.³⁶ But in most jurisdictions the conveyance or

³² Pullman v. Stebbins, 51 Fed. 10. See ante, § 200; post, § 268. See also, Williams v. Kemper, 99 Minn. 301, 109 N. W. 242 (nonresidence); Bank of Commerce & Trusts of Richmond, Va. v. McArthur, 256 Fed. 84, 86.

³³ Parker v. Carolina Sav. Bank, 53 S. C. 583, 590, 31 S. E. 673, 69 Am. St. Rep. 888, 891; O'Brien v. Stambach, 101 Iowa 40, 69 N. W. 1133, 63 Am. St. Rep. 368; Williams v. Adler-Goldman Commission Co., 227 Fed. 374; s. c., 211 Fed. 530; Case v. Beauregard, 101 U. S. 688, 25 L. Ed. 1004; Lion Bonding & Surety Co. v. Karatz, 280 Fed. 532, 537 (receiver-ship).

³⁴ Albany & Rensselaer Iron & Steel Co. v. Southern Agricultural Works, 76 Ga. 135, 2 Am. St. Rep. 26.

³⁵ Chicago, M. & St. P. Ry. Co. v. Third Nat. Bank of Chicago, 134 U. S. 276, 33 L. Ed. 900, 10 Sup. Ct. 550; Beach v. Miller, 130 Ill. 162, 22 N. E. 464, 17 Am. St. Rep. 291; Montgomery v. Phillips, 53 N. J. Eq. 203, 31 Atl. 622; Cole v. Millerton Iron Co., 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615.

A mortgage by a corporation to one of its directors, which is kept from record until the corporation becomes insolvent, is fraudulent and void as against other creditors. Montgomery v. Phillips, 53 N. J. Eq. 203, 31 Atl. 622.

³⁶ See Booth v. Bunce, 33 N. Y. 139, 88 Am. Dec. 372; Montgomery Web Co. v. Dienelt, 133 Pa. St. 585, 19 Atl. 428, 19 Am. St. Rep. 663.

transfer is valid as between the parties, and merely voidable at the suit of creditors, and the remedy of the creditors is in equity only.³⁷ This rule applies when the members of a corporation form a new corporation, and cause a transfer to it of all the assets of the old corporation without consideration, or without any other consideration than an assumption by the new corporation of all the debts of the old corporation.³⁸

Subsequent creditors.—If a debtor disposes of his property with intent to defraud those to whom he expects to become indebted, this may be a fraud against them, so as to entitle them to attack the conveyance or transfer.³⁹ It is a well-settled rule of law, however, that if an individual, without any intent to defraud creditors, disposes of his property for an inadequate consideration, or without any consideration at all, subsequent creditors cannot sue to set the conveyance aside and reach the property. They are not injured, for they have given credit to the debtor in the *status* which he had after the conveyance was made. This rule applies to creditors of corporations, as well as to creditors of natural persons. The assets of a corporation are not held by it in trust for the benefit of its creditors in any such sense as to entitle a creditor to attack as fraudulent a voluntary conveyance made by the corporation before he became a creditor.⁴⁰

General creditors.—In most jurisdictions, except where there is a statutory provision to the contrary, it is the settled rule that creditors cannot come into a court of equity by a creditors' bill to set aside a fraudulent conveyance by a corporation, and subject

³⁷ *Citizens' Bank of Kingman v. McClelland*, 53 Kan. 699, 37 Pac. 132; *Sharples Co. v. Harding Creamery Co.*, 78 Neb. 795, 111 N. W. 783, 11 L. R. A. (N. S.) 863.

³⁸ *Hibernia Ins. Co. v. St. Louis & N. O. Transp. Co.*, 4 McCrary 432, 13 Fed. 516; *In re American Candy Mfg. Co.*, 256 Fed. 87, 88; *Cole v. Millerton Iron Co.*, 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; *Grenell v. Detroit Gas Co.*, 112 Mich. 70, 70 N. W. 413; *Montgomery Web Co. v. Dienelt*, 133 Pa. St. 585, 19 Atl. 428, 19 Am. St. Rep. 663; *Vance v. McNabb Coal & Coke Co.*, 92 Tenn. 47, 20 S. W. 424. And see post, § 238.

³⁹ *United States Rubber Co. v.*

American Oak Leather Co., 96 Fed. 891; *Brent v. Simpson*, 238 Fed. 285; *Atlanta & Walworth Butter & Cheese Ass'n v. Smith*, 141 Wis. 377, 123 N. W. 106, 32 L. R. A. (N. S.) 137, 135 Am. St. Rep. 42; *Nix v. Miller*, 26 Colo. 203, 57 Pac. 1084.

⁴⁰ *Graham v. La Crosse & M. R. Co.*, 102 U. S. 148, 26 L. Ed. 106; *Morgan Bros. v. Dayton Coal & Iron Co.*, 134 Tenn. 228, 183 S. W. 1019, Ann. Cas. 1917 E 42; *Hamilton v. Menominee Falls Quarry Co.*, 106 Wis. 352, 81 N. W. 876; *Phillips v. Carter*, 266 Fed. 444. But see *Beach v. Williamson*, 78 Fla. 611, 83 So. 860, 9 A. L. R. 1438 (note on rights of creditors to attack conveyances of property by a corporation to directors or officers).

the property to the satisfaction of their claims, when they have no lien by mortgage, deed of trust, or otherwise, unless they have, at least, recovered a judgment against the corporation, or unless, because the corporation has been dissolved, or for some other reason, recovery of a judgment is impossible.⁴¹ The corporation's assets are not a trust fund in the sense that a creditor may proceed in equity while the legal remedy has not been exhausted. The fact that a simple contract claim has not been reduced to judgment and execution issued thereon may be waived, as by consenting to the appointment of receivers.⁴²

§ 230. Withdrawal of assets by stockholders.—A creditor of a corporation, after the recovery of a judgment against it, and the return of an execution thereon unsatisfied, or under some circumstances without this, may maintain a suit in equity to reach and subject to the payment of his claim assets of the corporation fraudulently or illegally withdrawn by or distributed among stockholders.

It is well settled that a corporation cannot directly or indirectly distribute its assets among its stockholders, or allow stockholders to withdraw its assets, otherwise than in the lawful payment of dividends out of profits,⁴³ leaving its creditors unpaid. And if this is done, the stockholders may be compelled to repay what they have received, at the suit of creditors, or of a receiver, assignee, or trustee representing them.⁴⁴ The courts sometimes base this rule on the ground that the assets are a trust fund for the benefit of creditors, but it is not at all necessary to resort to any such theory. For the stockholders to withdraw the assets of a corporation, leaving debts of the corporation unpaid, is a fraud

⁴¹ *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 37 L. Ed. 1113, 14 Sup. Ct. 127 (bill by simple contract creditors for appointment of receiver, sale of property and collection of unpaid stock subscriptions of insolvent corporation dismissed); *Ozan Lumber Co. v. Davis Sewing Mach. Co.*, 284 Fed. 161; *Atlas Nat. Bank v. John Moran Packing Co.*, 138 Mo. 59, 39 S. W. 71; *Wehn v. Fall*, 55 Neb. 547, 76 N. W. 13, 70 Am. St. Rep. 397.

⁴² *In re Metropolitan Ry. Receivership*, 208 U. S. 90, 109, 52 L. Ed. 403, 28 Sup. Ct. 219, 221.

⁴³ See ante, § 158.

⁴⁴ *Guinness v. Land Corporation of Ireland*, 22 Ch. Div. 349, 375; *Wood v. Dummer*, 3 Mason, 308, Fed. Cas. No. 17944; *Pierce v. United States*, 255 U. S. 398, 65 L. Ed. 697, 41 Sup. Ct. 365; *Lebens v. Nelson*, 148 Minn. 240, 181 N. W. 350; *Buck v. Ross*, 68 Conn. 29, 35 Atl. 763, 57 Am. St. Rep. 60; *In re Brockway Mfg. Co.*, 89 Me. 121, 35 Atl. 1012, 56 Am. St. Rep. 401; *Bartlett v. Drew*, 57 N. Y. 587; *Clapp v. Peterson*, 104 Ill. 26; *Commercial Nat. Bank v. Burch*, 141 Ill. 519, 31 N. E. 420, 33 Am. St. Rep. 331; *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133.

upon the creditors who contract with the corporation on the faith of its capital stock.⁴⁵

This rule applies whenever there is a wrongful withdrawal of assets by stockholders to the injury of creditors, however it may be effected. It applies, for example, when the assets of a corporation, or any part of them, are distributed among stockholders as dividends, or otherwise, when there are no surplus profits available for the payment of dividends, and they are paid out of assets representing the capital stock.⁴⁶ So where a corporation purchases or accepts a surrender of shares of its stock, and pays therefor out of the capital of the company, the creditor may follow the assets so withdrawn into the hands of the stockholder.⁴⁷ So where a corporation releases a stockholder from liability on his subscription without an equivalent from him, and not under a *bona fide* compromise, this is invalid against creditors.⁴⁸ And where the stockholders of a corporation organize another corporation, in which they are the only or the principal stockholders, and cause the old corporation to transfer its assets to the new without adequate equivalent to which the creditors can resort for satisfaction of

⁴⁵ Ante, § 225. See also, Mackall v. Pocock, 136 Minn. 8, 161 N. W. 228, L. R. A. 1917 C 390 (trustee in bankruptcy may recover back dividends paid for benefit of subsequent creditors, it not appearing that they did not deal with the corporation on the faith of its capital being unimpaired). But see Montgomery v. Whitehead, 40 Colo. 320, 90 Pac. 509, 11 L. R. A. (N. S.) 230.

⁴⁶ Wood v. Dummer, 3 Mason 308, Fed. Cas. No. 17944; Bartlett v. Drew, 57 N. Y. 587; Williams v. Boice, 38 N. J. Eq. 364; Singer v. Hutchinson, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133; Davenport v. Lines, 72 Conn. 118, 44 Atl. 17; Grant v. Ross, 100 Ky. 44, 37 S. W. 263. And see ante, §§ 158, 162. Compare McDonald v. Williams, 174 U. S. 397, 43 L. Ed. 1022, 19 Sup. Ct. 743. The passive receipt by shareholders in a national bank of a dividend in the *bona fide* belief that the dividend was being paid out of profits, while the bank was in fact solvent, did not make them liable to the receiver on the subsequent insolvency of the bank. Compare Mackall v. Pocock, 136 Minn. 8, 161 N. W. 228, L. R. A. 1917 C 390; Williams v.

Boice, 38 N. J. Eq. 364, 367; Digney v. Blanchard, 226 Mass. 335, 339, 115 N. E. 424, 426.

⁴⁷ Buck v. Ross, 68 Conn. 29, 35 Atl. 763, 57 Am. St. Rep. 60; Crandall v. Lincoln, 52 Conn. 73, 52 Am. Rep. 562; Clapp v. Peterson, 104 Ill. 26; Commercial Nat. Bank v. Burch, 141 Ill. 519, 31 N. E. 420, 33 Am. St. Rep. 331. See In re Fechheimer Fishel Co., 212 Fed. 357; Coleman v. Tepel, 230 Fed. 63; Johnson v. Canfield-Swigart Co., 292 Ill. 101, 126 N. E. 608; Gnichtel v. Stone, 233 N. Y. 465, 135 N. E. 852.

⁴⁸ Sawyer v. Hoag, 17 Wall. (U. S.) 610, 620, 21 L. Ed. 731; Potts v. Wallace, 146 U. S. 689, 36 L. Ed. 1135, 13 Sup. Ct. 196; Farnsworth v. Robbins, 36 Minn. 369, 31 N. W. 349. And see ante, § 42.

If subscribers for stock give notes to the corporation for the amount of the stock, the forgiveness of them, that is the surrender of them, canceled as paid to the maker when they have not been paid is a fraudulent transfer as against creditors. Hall & Farley v. Alabama Terminal & Improvement Co., 143 Ala. 464, 39 So. 285, 2 L. R. A. (N. S.) 130, 5 Ann. Cas. 363.

their claims the creditors may set aside the transfer as a fraudulent conveyance.⁴⁹

When the assets of a corporation have been wrongfully distributed among its stockholders, creditors of the corporation may file a bill against some of such stockholders to reach the assets received by them, without making the others parties. If the defendants desire an equitable distribution of the burden among all the stockholders, they should file a cross-bill bringing in the other stockholders, or they may file an original bill in an independent action.⁵⁰ Corporations represent their stockholders in bringing and defending suits respecting the rights and obligations of the corporation, and therefore, in the absence of fraud or want of jurisdiction, a judgment on the merits against a corporation in an action by a creditor is conclusive of the validity and amount of his claim, as against stockholders who are made defendants to a creditors' bill to reach corporate assets wrongfully withdrawn and in the hands of such stockholders.⁵¹

§ 231. Assignments for the benefit of creditors.—A corporation, like a natural person, may make a general assignment for the benefit of its creditors, unless prevented by statute, as is the case in some jurisdictions.

As a general rule, a corporation in failing circumstances has the same power and right as a natural person to make a voluntary assignment of all its property and choses in action for the benefit of creditors, unless it is prevented from doing so by some express statutory provision.⁵² And in most jurisdictions, as we shall see in another section, it may prefer particular creditors, unless this is prohibited by statute.⁵³ In some jurisdictions, however, transfers

⁴⁹ *Montgomery Web Co. v. Dienelt*, 133 Pa. St. 585, 19 Atl. 428, 19 Am. St. Rep. 663; *Cole v. Millerton Iron Co.*, 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; *Brayton & Lawbaugh v. Monarch Lumber Co.*, 87 Ore. 365, 169 Pac. 528, 170 Pac. 717. And see post, § 238.

⁵⁰ *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133; *Bartlett v. Drew*, 57 N. Y. 587; *Chatham v. Mecklenburg Realty Co.*, 180 N. C. 500, 105 S. E. 329.

⁵¹ *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133. See ante, §§ 201, 202.

⁵² *Chamberlain v. Bromberg*, 83 Ala. 576, 3 So. 434; *Worthen v. Gri-*

ffith, 59 Ark. 562, 28 S. W. 286, 43 Am. St. Rep. 50; *Albany & R. Iron & Steel Co. v. Southern Agricultural Works*, 76 Ga. 135, 2 Am. St. Rep. 26; *Boynton v. Roe*, 114 Mich. 401, 72 N. W. 257; *Hutchinson v. Green*, 91 Mo. 367, 1 S. W. 853; *Vanderpoel v. Gorman*, 140 N. Y. 563, 35 N. E. 932, 24 L. R. A. 548, 37 Am. St. Rep. 601; *In re Creech Lumber Co.*, 240 Fed. 8; *Collins v. Williamson*, 229 Fed. 59. See *United States v. Butterworth-Judson Corp.*, 269 U. S. 504, 70 L. Ed. 380, 46 Sup. Ct. 179.

⁵³ See post, § 232; *In re Grocer's Baking Co.*, 266 Fed. 900; *Ames & Frost Co. v. Heslet*, 19 Mont. 188, 47 Pac. 805, 61 Am. St. Rep. 496.

or assignments by corporations when insolvent, or in contemplation of insolvency, are expressly prohibited by statute and declared void, and such statutes prevent an assignment for the benefit of creditors by a corporation, although it may be without preferences.⁵⁴ An assignment for creditors may be set aside, even though valid, by bankruptcy proceedings commenced within four months from the date of the assignment.⁵⁵

§ 232. Preference of creditors, and right of creditors to obtain preference.—In most jurisdictions, but not in all, a corporation, although it may be insolvent, and may have ceased or be about to cease to do business, may lawfully prefer one or more creditors to the exclusion of others by payment, conveyance, assignment, mortgage, pledge, confession of judgment, or otherwise, unless prevented by statute; and one creditor, unless so prevented, may obtain a preference by execution, attachment, or garnishment.

In some jurisdictions it has been held that when a corporation becomes insolvent, and makes an assignment for the benefit of creditors, or ceases business, or determines to cease business, although no proceedings may have been instituted against it for winding up its affairs, its assets are so far a trust fund for the benefit of *all* its creditors ratably, that it cannot, as a natural person may, prefer one or more of its creditors, to the exclusion of others, by a conveyance, mortgage, pledge, assignment, confession of judgment, or otherwise. If it attempts to do so, a court of equity will set the preference aside, and distribute the assets *pro rata* among all the creditors.⁵⁶ This view, however, is contrary to

Contra, *Rouse v. Merchants' Nat. Bank*, 46 Ohio St. 493, 22 N. E. 293, 5 L. R. A. 378, 15 Am. St. Rep. 644; *Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co.*, 86 Tex. 143, 24 S. W. 16, 22 L. R. A. 802n.; *Thompson, Corporations* (2nd Ed.), secs. 3418-3422.

⁵⁴ *Fletcher, Corporations*, sec. 5015.

⁵⁵ *Fletcher, Corporations*, sec. 5195.

⁵⁶ *Rouse v. Merchants' Nat. Bank*, 46 Ohio St. 493, 22 N. E. 293, 5 L. R. A. 378, 15 Am. St. Rep. 644; *Star Hardware & Supply Co. v. Toledo Steel Castings Co.*, 90 Ohio St. 171, 106 N. E. 966; *Furber v. Williams-Flower Co.*, 21 S. D. 228, 111 N. W. 548, 8 L. R. A. (N. S.) 1259, 15 Ann. Cas. 1216; *Adams & Westlake Co. v. Deyette*, 5 S. D. 418, 59 N. W. 214, 49

Am. St. Rep. 887; s. c., 8 S. D. 119, 65 N. W. 471, 31 L. R. A. 497, 59 Am. St. Rep. 751, *Kellam, J.*, dissenting; *Tradesman Pub. Co. v. Knoxville Car Wheel Co.*, 95 Tenn. 634, 32 S. W. 1097, 31 L. R. A. 593, 49 Am. St. Rep. 943; *Memphis Barrel & Heading Co. v. Ward*, 99 Tenn. 172, 42 S. W. 13, 63 Am. St. Rep. 825; *Fowler v. Bell*, 90 Tex. 150, 37 S. W. 1058, 39 L. R. A. 254, 59 Am. St. Rep. 788; *Cook v. Moody*, 18 Wash. 114, 50 Pac. 1020, 63 Am. St. Rep. 872. See note in 19 A. L. R. 320, 328, on right of corporation to prefer creditors.

Corporate creditors are confined to corporate assets, while natural persons, though insolvent, may subsequently acquire property and discharge all their previous obligations.

the very decided weight of authority. The majority of states hold that a corporation may prefer one or more creditors, although insolvent paying them to the exclusion of the others, just as a natural person may do, unless prevented by some statutory provision.⁵⁷ The assets of a corporation are not a trust fund for creditors, so long as no proceedings for a winding-up have been instituted, even though it may be hopelessly insolvent, except to such an extent that they cannot be distributed among or withdrawn by stockholders to the prejudice of creditors.

It would appear to be unjust for a corporation in failing circumstances to turn over all or a great portion of its assets to one or more favored creditors, leaving others holding claims equally well founded without any means of collection. Many courts, however, hold that preferences may be given by an insolvent corporation, while some others hold that they may not be given, particularly where it is no longer carrying on its business. Some courts hold that a preference may be given to a creditor even if he is a director of the insolvent company, although most courts hold that a director or officer may not take such advantage. There is a possible distinction as to the matter of preferences between a corporation which is insolvent, but which continues in business with an honest intention and effort to redeem its fortunes, and a case where the insolvency is hopeless, so that further prosecution of the enterprise will simply result in further losses, and it is apparent that the shareholders have no further interest in the assets remaining. In such a case the equitable claims of the creditors should be regarded as fixed upon all the company's assets as an equitable charge or lien.⁵⁸

The need for equal distribution of its assets among corporate creditors is therefor more urgent than in the case of an individual debtor. See 38 A. L. R. 90.

⁵⁷ *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 U. S. 312, 39 L. Ed. 713, 15 Sup. Ct. 621, rev'g 44 Fed. 231; *In re Grocers' Baking Co.*, 266 Fed. 900; *O'Bear Jewelry Co. v. Volfer*, 106 Ala. 205, 17 So. 525, 28 L. R. A. 707, 54 Am. St. Rep. 31; *Catlin v. Eagle Bank of New Haven*, 6 Conn. 233; *Rockford Wholesale Grocery Co. v. Standard Grocery & Meat Co.*, 175 Ill. 89, 51 N. E. 642, 67 Am. St. Rep. 205; *First Nat. Bank of Crawfordsville v. Dovetail Body & Gear Co.*, 143 Ind. 550, 40 N. E.

810, 52 Am. St. Rep. 435; *Cosmopolitan Trust Co. v. S. L. Agoos Tan. Co.*, 245 Mass. 69, 139 N. E. 806; *Austin v. First Nat. Bank of Kalamazoo*, 100 Mich. 613, 59 N. W. 597; *Schufeldt v. Smith*, 131 Mo. 280, 31 S. W. 1039, 29 L. R. A. 830, 52 Am. St. Rep. 628; *Moller v. Keystone Fibre Co.*, 187 Pa. St. 553, 41 Atl. 478; *Ford v. Hill*, 92 Wis. 188, 66 N. W. 115, 53 Am. St. Rep. 902; *Slack v. Northwestern Nat. Bank of Superior*, 103 Wis. 57, 79 N. W. 51, 74 Am. St. Rep. 841. See notes, 19 A. L. R. 320, 38 A. L. R. 90.

⁵⁸ *Russe & Burgess v. Miesner Lumber & Mfg. Co. (Mo. App.)*, 243 S. W. 353. See notes 19 A. L. R. 333,

Right of creditors to obtain preferences by attachment, execution, etc.—By the great weight of authority, the fact that a corporation is insolvent does not prevent a creditor from obtaining a lien or preference over other creditors by obtaining a judgment, or by issuing and levying an execution or attachment, or other process of law, unless there is some express statutory provision in the way, as will be hereafter explained.⁵⁹ In a few states, however, this doctrine is not recognized, but it is held that when a corporation becomes insolvent and suspends business, makes an assignment, or does any other overt act indicating positive and assured insolvency, its assets become so far a trust fund for the benefit of all its creditors that one of them cannot obtain a preference over others, even by execution, attachment, or other adverse proceedings.⁶⁰

Statutory provisions affecting the validity of preferences.—In some jurisdictions there are express statutory provisions taking away altogether or restricting the common-law power of a corporation to prefer creditors when it is insolvent or contemplates insolvency, and the right of creditors to obtain preferences. These statutes vary, of course, in the different states.⁶¹ The Bankruptcy Act invalidates preferences as against the trustee in bankruptcy if made or suffered within four months before filing the petition. It is necessary, however, that the creditor should at the time thereof have reasonable cause to believe that the debtor was insolvent and that a preference would result.⁶²

§ 233. Officers as creditors.—The officers of a corporation may deal with it and become creditors, if they act in good faith, and may take security or payment, or enforce their claims against it, like any other creditor; but in most jurisdictions, although not

349, 38 A. L. R. 91, 92; Morawetz, Corporations, secs. 786, 787.

⁵⁹ Standard Chemical & Oil Co. v. Faircloth, 200 Ala. 657, 77 So. 31; Ballin v. Merchants' Exch. Bank, 89 Wis. 278, 61 N. W. 1118, 27 L. R. A. 357, 46 Am. St. Rep. 834.

⁶⁰ Willis v. Mann Const. Co., 145 Tenn. 318, 236 S. W. 282; M. L. Barrett & Co. v. Chilton (Mo. App.), 241 S. W. 434; Memphis Barrel & Heading Co. v. Ward, 99 Tenn. 172, 42 S. W. 13, 63 Am. St. Rep. 825; Compton v. Schwabacher Bros. & Co., 15 Wash. 306, 46 Pac. 338; Orr &

Lindsley Shoe Co. v. Thompson, 89 Tex. 501, 35 S. W. 473.

⁶¹ See Fletcher, Corporations, 5121-5143; 19 A. L. R. 358-379 note.

⁶² Grandison v. Robertson, 220 Fed. 985; Hoover Steel Ball Co. v. Schafer Ball Bearings Co., 89 N. J. Eq. 478, 106 Atl. 36; In re McDonald & Sons, 178 Fed. 487; In re Grocers' Baking Co., 266 Fed. 900; In re Will V. Connell Co., 278 Fed. 288; Musbaum v. City Bank & Trust Co., 132 Va. 54, 110 S. E. 363; 34 Harvard Law Rev. 547; Bankruptcy Act, sec. 60b.

in all, after the corporation has become insolvent and ceased to do business, or determined to do so, its directors and other officers occupy a quasi trust relation towards creditors, by reason of their position and their control over the assets and management of the corporation, and will not be allowed to obtain any preference over other creditors, either by act of the corporation or its officers, or by adversary proceedings against it.

So long as a corporation is solvent, it may borrow money from or otherwise contract with an officer or director, and may pay him, or mortgage or pledge property to secure him, just as it may pay or secure any other creditor, and, if it afterwards becomes insolvent, the conveyance, mortgage, or pledge will be valid as against other creditors, although the result may be to leave them unpaid.⁶³ This is true of a mortgage or pledge by a corporation to secure a debt upon which its officers are liable as sureties or indorsers, or to secure the officers themselves against liability or loss by reason of their guaranty, suretyship, or indorsement.⁶⁴ In all such cases, however, the transaction must be free from fraud. A transaction in which a corporation conveys, mortgages, or pledges property to its directors or other managing officers will be closely scrutinized when attacked by a creditor upon the insolvency of the corporation, and will not be sustained if it was in fact made, not in good faith and for a *bona fide* debt, but with intent to hinder and delay or defraud creditors.⁶⁵

§ 234. Preferences to officers after insolvency.

The power of an insolvent corporation to prefer creditors generally has been considered in a former section, and we have seen that most of the courts uphold preferences unless they are prohibited by statute.⁶⁶ Suppose that the directors of an insolvent

⁶³ See ante, § 122a; *Twin-Lick Oil Co. of West Virginia v. Marbury*, 91 U. S. 587, 23 L. Ed. 328; *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 U. S. 312, 39 L. Ed. 713, 15 Sup. Ct. 621, rev'g 44 Fed. 231; *O'Conner Min. & Mfg. Co. v. Coosa Furnace Co.*, 95 Ala. 614, 10 So. 290, 36 Am. St. Rep. 251; *Harle-Haas Drug Co. v. Rogers Drug Co.*, 19 Wyo. 35, 113 Pac. 791, Ann. Cas. 1913 E 181.

⁶⁴ *Montgomery v. Phillips*, 53 N. J. Eq. 203, 31 Atl. 622; *In re New Memphis Gaslight Company Cases*, 105 Tenn. 268, 60 S. W. 206, 80 Am. St. Rep. 880. See note 5 A. L. R.

561, on right of insolvent corporation to secure officers, directors or stockholders for contemporaneous loan to the corporation; also 19 A. L. R. 1087; in general a corporation may though insolvent secure a director or other officer for a contemporaneous loan made in good faith; a distinction is recognized between security given for a present loan and for a past indebtedness or liability.

⁶⁵ *Montgomery v. Phillips*, 53 N. J. Eq. 203, 31 Atl. 622; *Rickerson Roller-Mill Co. v. Farrell Foundry & Machine Co.*, 75 Fed. 554; *Sidell v. Missouri Pac. Ry. Co.*, 78 Fed. 724.

⁶⁶ Ante, § 232.

corporation are also creditors, and seeing that the condition of the corporation is hopeless they unite as directors in ordering that a mortgage be made to themselves by the president and secretary, to secure their debts against the corporation to the detriment of all the other creditors. Upon the plainest principles of fair dealing and common honesty such an advantage taken by the insiders ought to be held fraudulent as to other creditors. Some of the courts, however, have held that an insolvent corporation may prefer its own directors or other officers, if they are *bona fide* creditors, and the transaction is free from actual fraud,⁶⁷ and if the corporation is represented by other officers or by the stockholders;⁶⁸ and it has also been held that a director or other officer of a corporation, although he may know that it is insolvent, may obtain a preference over other creditors by an execution or attachment for a *bona fide* debt due to him from the corporation.⁶⁹

This view, however, is not supported by the weight of authority. On the contrary, most of the courts hold that when a corporation becomes insolvent, and can no longer continue, the directors and other managing officers, although not properly trustees, occupy, at the least, a fiduciary relation towards creditors by reason of their position and their custody of the assets; and that they cannot, by conveyance, mortgage, pledge, confession of judgment, or otherwise, secure to themselves, as creditors, any preference or advantage over other creditors, but that the most they can claim is the right to come in and share *pro rata* with the other creditors.⁷⁰

⁶⁷ In *re* Wincham Ship-Building, Boiler & Salt Co. (Poole, Jackson & Whyte's Case), 9 Ch. Div. 322; *Corey v. Wadsworth*, 118 Ala. 488, 25 So. 503, 44 L. R. A. 766; *Worthen v. Griffith*, 59 Ark. 562, 28 S. W. 286, 43 Am. St. Rep. 50; *First Nat. Bank of Crawfordsville v. Dovetail Body & Gear Co.*, 143 Ind. 550, 40 N. E. 810, 52 Am. St. Rep. 435; *Buell v. Buckingham*, 16 Iowa 284, 85 Am. Dec. 516; *Garrett v. Burlington Plow Co.*, 70 Iowa 697, 29 N. W. 395, 59 Am. Rep. 461; *Warfield v. Marshall County Canning Co.*, 72 Iowa 666, 34 N. W. 467, 2 Am. St. Rep. 263; *Rollins v. Shaver Wagon & Carriage Co.*, 80 Iowa 380, 45 N. W. 1037, 20 Am. St. Rep. 427; *Schufeldt v. Smith*, 131 Mo. 280, 31 S. W. 1039, 29 L. R. A. 830, 52 Am. St. Rep. 628. See 19 A. L. R. 334 note.

⁶⁸ See *Rickerson Roller-Mill Co. v.*

Farrell Foundry & Machine Co., 75 Fed. 554; *Savage v. Miller*, 56 N. J. Eq. 432, 36 Atl. 578, 39 Atl. 665.

⁶⁹ *Rollins v. Shaver Wagon & Carriage Co.*, 80 Iowa 380, 45 N. W. 1037, 20 Am. St. Rep. 427; *Nebraska Nat. Bank v. Clark*, 58 Neb. 183, 78 N. W. 527; *Title Insurance & Trust Co. v. California Development Co.*, 171 Cal. 173, 152 Pac. 542, 560. The director who is also a creditor is precluded from using his position as director to obtain preference over other creditors in payment of his own debt or any debt in which he is materially interested. But he may levy an attachment, if he is not taking advantage of his position as director in the prosecution or defence of the action.

⁷⁰ *Heim v. Jobes*, 14 Fed. (2d) 29: "The great weight of judicial authority supports the rule that, where

It is regarded as inequitable that the officers whose position gives them a knowledge and control of the company's affairs and who are responsible to use their efforts for the benefit of all concerned, should protect their own claims to the detriment of those who are equally in peril, as if the officers and crew of a sinking ship should forsake the passengers. In all jurisdictions, of course, a preference obtained by the directors or other officers of a corporation may be successfully attacked by other creditors if they can show that there was actual fraud or unfairness.⁷¹

Debts for which the directors or other managing officers are liable as guarantors, sureties, or indorsers are within this rule to such an extent that the officers cannot secure a preference, by way of indemnity or otherwise, for the purpose of exonerating themselves, to the prejudice of the other creditors.⁷² But the principal creditor, not being an officer of the corporation, may take advantage of a preference and enforce his security. The fact that the officers are liable as sureties, guarantors, or indorsers cannot affect his rights.⁷³ It has been held that the rule prohibiting the officers of an insolvent corporation from obtaining a preference over other creditors prevents the officers of an insolvent corporation from

a corporation is insolvent, its officers and directors must not use the assets of the corporation to prefer themselves as creditors to the prejudice of other general creditors. *Stuart v. Larson*, 298 Fed. 223, 38 A. L. R. 79; *In re Lamie Chemical Co.*, 296 Fed. 24, 30, 31; *Fletcher Encyclopedia Corporations*, vol. 8, § 5145, p. 8753; 14 A. C. J. p. 901, § 3080''; 19 A. L. R. 338n; 38 *Harvard Law Rev.* 521.

⁷¹ See *Rickerson Roller-Mill Co. v. Farrell Foundry & Machine Co.*, 75 Fed. 554.

The court recognized that the directors of an insolvent Michigan corporation in process of liquidation had a legal right to devote the entire assets to the payment of their debts, leaving others unpaid. But if the excluded creditor had been misled into being quiescent when he might have been vigilant in the assertion of his claim, the preferential payment will be vacated and he will be allowed to receive his pro rata share. See *Thompson*, 27 *Amer. Law. Rev.* 846.

⁷² *Corey v. Wadsworth*, 99 *Ala.* 68, 11 *So.* 350, 23 *L. R. A.* 618, 42 *Am.*

St. Rep. 29; *Roseboom v. Whittaker*, 132 *Ill.* 81, 23 *N. E.* 339; *Sutton Mfg. Co. v. Hutchinson*, 63 *Fed.* 496; *Howe, Brown & Co. v. Sanford Fork & Tool Co.*, 44 *Fed.* 231, *aff'd* 157 *U. S.* 312, 39 *L. Ed.* 713, 15 *Sup. Ct.* 621; *In re Lamie Chemical Co.*, 296 *Fed.* 24 (mortgage withheld from record); *Atlas Tack Co. v. Macon Hardware Co.*, 101 *Ga.* 391, 29 *S. E.* 27; *Campbell Printing Press & Mfg. Co. v. Marder, Luse & Co.*, 50 *Neb.* 283, 69 *N. W.* 774, 61 *Am. St. Rep.* 573; *Gantenbein v. Bowles*, 103 *Ore.* 277, 203 *Pac.* 614.

⁷³ *Weihl Probasco & Co. v. Atlanta Furniture Mfg. Co.*, 89 *Ga.* 297, 15 *S. E.* 282; *Atlas Tack Co. v. Macon Hardware Co.*, 101 *Ga.* 391, 29 *S. E.* 27; *Waggoner-Gates Milling Co. v. Ziegler-Zaiss Commission Co.*, 128 *Mo.* 473, 31 *S. W.* 28; *Rockford Wholesale Grocery Co. v. Standard Grocery & Meat Co.*, 175 *Ill.* 89, 51 *N. E.* 642, 67 *Am. St. Rep.* 205; *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 *U. S.* 312, 39 *L. Ed.* 713, 15 *Sup. Ct.* 621, *rev'g* 44 *Fed.* 231.

preferring another corporation, of which they are also officers.⁷⁴ But mere relationship of a creditor to one or more of the directors or officers of an insolvent corporation does not invalidate a transaction by which he is given a preference, provided the transaction is otherwise fair and free from fraud.⁷⁵

By the weight of authority, a corporation is not insolvent, within the meaning of the rule prohibiting preferences by insolvent corporations to their officers, merely because it is embarrassed and cannot pay its debts as they become due, or even because its assets, if sold, would not bring enough to pay all its liabilities, if it is still prosecuting its business in good faith, with a reasonable prospect and expectation of continuing to do so.⁷⁶

§ 235. **Stockholders as creditors.**—The stockholders of a corporation may deal with it and become creditors, if the transaction is free from fraud, and may enforce their claims in like manner as any other creditor; and in most jurisdictions, unless prevented by statute, the corporation may, by payment, mortgage, confession of judgment, or otherwise, in the absence of fraud, prefer them over other creditors, or they may themselves obtain a preference by adversary proceedings against it.

The individual stockholders of a corporation may lend it money or otherwise contract with it, and take a mortgage, pledge, or other security from it, or purchase property from it, or take property or money from it in payment of a debt, to substantially the same extent as a natural person, and, in the absence of fraud, the transaction will be valid as against an attack by other creditors of the corporation.⁷⁷ But they cannot make use of their position to perpetrate a fraud upon other creditors.⁷⁸ The rule recognized in

⁷⁴ *Slack v. Northwestern Nat. Bank of Superior*, 103 Wis. 57, 79 N. W. 51, 74 Am. St. Rep. 841; *German Nat. Bank of Hastings v. First Nat. Bank of Hastings*, 55 Neb. 86, 75 N. W. 531.

⁷⁵ *Ragland v. McFall*, 137 Ill. 81, 27 N. E. 75; *Illinois Steel Co. v. O'Donnell*, 156 Ill. 624, 41 N. E. 185, 31 L. R. A. 265, 47 Am. St. Rep. 245.

⁷⁶ *Corey v. Wadsworth*, 99 Ala. 68, 11 So. 350, 23 L. R. A. 618, 42 Am. St. Rep. 29; *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 U. S. 312, 39 L. Ed. 713, 15 Sup. Ct. 621, rev'g 44 Fed. 231; *Sabin v. Columbia Fuel Co.*, 25 Ore. 15, 34 Pac. 692; 35 Pac. 854, 42 Am. St. Rep. 756. See

Gantenbein v. Bowles, 103 Ore. 277, 203 Pac. 614; *Cardozo v. Brooklyn Trust Co.*, 228 Fed. 333. See also, note 19 A. L. R. 333.

⁷⁷ See *Gordon v. Preston*, 1 Watts (Pa.) 385, 26 Am. Dec. 75; *Lexington Life, Fire & Marine Ins. Co. v. Page*, 17 B. Mon. (Ky.) 412, 66 Am. Dec. 165; *Duncomb v. New York, Housatonic & N. R. Co.*, 84 N. Y. 190; *Merrick v. Peru Coal Co.*, 61 Ill. 472; *Shumpert v. National State Bank*, 231 Fed. 82.

⁷⁸ *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 L. Ed. 731; *Keith v. Kilmer*, 261 Fed. 733, 9 A. L. R. 1287, 1296n (a stockholder who sells his stock to the corporation cannot prove

most jurisdictions, that the directors and other managing officers of an insolvent corporation are precluded, by reason of their position, from obtaining as creditors any preference over other creditors, does not apply to mere stockholders who are creditors of the corporation, but who have no custody of or control over the assets of the corporation. They occupy no fiduciary relation, in any sense, towards other creditors, and, where preferences by insolvent corporations are allowed at all, they may be preferred by the corporation to the exclusion of others, if they are *bona fide* creditors, and the transaction is perfectly fair and free from fraud; and they may obtain a preference by execution, attachment, or other legal process.⁷⁹ This does not apply, however, when the preferred stockholder is also a director or other managing officer, or where he is the sole stockholder, or a majority stockholder, and takes advantage of his position to obtain the preference over other creditors.⁸⁰ In some states statutes prohibit insolvent corporations from giving preferences to creditors who are stockholders as well as to those who are officers.⁸¹

§ 236. Appointment of receivers.—Statutes in many jurisdictions expressly provide for the appointment of a receiver, and also for the winding up of a corporation, at the suit of creditors, under certain circumstances; and in the absence of a statute, a court of equity, has jurisdiction to appoint a receiver, on his application, when necessary, after he has exhausted his remedies at law, for the purpose of reaching or preserving assets of the corporation which he is entitled to have applied to the payment of his claim,

his claim for damages for breach of an executory contract of sale against the assets in competition with ordinary creditors. The same is true of a claim for the price. He can share only after all the creditors have been paid. The capital cannot be impaired or withdrawn by stockholders to the injury of creditors); In re Fechheimer Fishel Co., 212 Fed. 357.

⁷⁹ Lexington Life, Fire & Marine Ins. Co. v. Page, 17 B. Mon. (Ky.) 412, 66 Am. Dec. 165; Bouton v. Smith, 113 Ill. 481; Whitwell v. Warner, 20 Vt. 425; Sargent v. Webster, 13 Metc. (Mass.) 497, 46 Am. Dec. 743; Hoggan v. Price River Irr. Co., 55 Utah 170, 184 Pac. 536 (even though corporation is insolvent); Callahan v. Pioneer Nurseries Co., 49

Utah 541, 164 Pac. 878, 19 A. L. R. 1082. But see State Bank of Chicago v. Idaho-Oregon Light & Power Co., 219 Fed. 583; Lamb v. Russell, 81 Miss. 382, 32 So. 916; 19 A. L. R. 356, 357n.

⁸⁰ Sidell v. Missouri Pac. Ry. Co., 78 Fed. 724. And see Wortendyke v. Salladin, 45 Neb. 755, 64 N. W. 215; Atwater v. American Exch. Nat. Bank of Chicago, 152 Ill. 605, 38 N. E. 1017; Adams & Westlake Co. v. Deyette, 8 S. D. 119, 65 N. W. 471, 31 L. R. A. 497, 59 Am. St. Rep. 751; Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co., 86 Tex. 143, 24 S. W. 16, 22 L. R. A. 802.

⁸¹ Fletcher, Corporations, secs. 5160, 5164.

or on which he has a lien. Unless it is otherwise provided by statute, an application for a receiver is always addressed to the sound discretion of the court, and should not be granted except in a clear case. Mere insolvency of a corporation alone is no ground for the appointment of a receiver at the suit of a creditor, unless it is made so by statute.

It is well settled that a court of equity may, in its discretion, appoint a receiver of a corporation, or of specific property, at the suit of a creditor having a lien thereon by mortgage or otherwise, when there is imminent danger of the property being wasted, lost, or misapplied, unless it is placed in the possession of a receiver; and in such a case a receiver may be appointed either in a suit to foreclose the mortgage or other lien, or, in a clear case of necessity, before the time for foreclosing the same has arrived.⁸² It is often the case that the property of a corporation can be preserved for equitable distribution among creditors and stockholders only by the appointment of a receiver. Certain creditors may be threatening to bring suits on their claims, and the resulting forced sales of the property would cause great loss to the other creditors. More would be realized from a sale of the assets if the business were still being carried on by a receiver free from attachments and executions.

A receiver may be appointed in connection with a creditors' bill in equity at the suit of a judgment creditor of a corporation, for the purpose of reaching equitable assets of the corporation, or of preventing a fraudulent disposition of its property, and subjecting the same to the satisfaction of the judgment; and under some circumstances a receiver may be appointed at the suit of a general creditor. It may be laid down as a general rule that, to justify the appointment of a receiver on the application of a creditor, in the absence of any special statutory provision, it must appear that he has exhausted his legal remedies, or that the circumstances are such that to deny the application will lead to a wasting or loss of assets which otherwise might be made available for the payment of debts, and which cannot be availed of in any other manner as satisfactorily as by the appointment of a receiver. Ordi-

⁸² Mercantile Trust Co. of New York v. Missouri, K. & T. Ry. Co., 36 Fed. 221, 1 L. R. A. 397; Haas v. Chicago Bldg. Soc., 89 Ill. 498; Lehman v. Tallassee Mfg. Co., 64 Ala. 567; Des Moines Gas Co. v. West, 44

Iowa 23; Thompson v. Natchez Water & Sewer Co., 68 Miss. 423, 9 So. 821; Cheever v. Rutland & B. R. Co., 39 Vt. 653; National Guarantee Credit Corp. v. Worth & Co., 274 Pa. 148, 117 Atl. 914.

narily, a receiver should be appointed when there is such a showing, but not otherwise.⁸³

A creditor is entitled to the appointment of a receiver when the corporation has ceased to act, and the principal stockholders are fraudulently dealing with the property as their own.⁸⁴ When a corporation has no property that is subject to execution, as in the case of a corporation having no property except its franchise, or a *quasi* public corporation having no property except such as is necessary to enable it to exercise its franchises and to perform its duties to the public, a judgment creditor, unless some special remedy is provided by statute, may sue in equity for the appointment of a receiver and sequestration of the earnings of the corporation for the purpose of satisfying the judgment.⁸⁵ As a general rule, however, a court of equity cannot deprive a corporation of the control of its business, and appoint a receiver to receive its income and pay debts therefrom, at the suit of a creditor who has no specific lien by mortgage or otherwise. He must resort to the ordinary remedies provided by law.⁸⁶

In the absence of a statute authorizing such a step, a court of equity has no jurisdiction to appoint a receiver of a corporation at the suit of a creditor, on the ground that it is so managing its business that its assets may be wasted, or that it is about to make an improvident contract, lease, or conveyance, if the complainant has no lien, and no fraud or breach of trust is alleged.⁸⁷ Unless it

⁸³ *Cadogan v. Lyric Theatre*, [1894] 3 Ch. 338; *Covington Drawbridge Co. v. Shepherd*, 21 How. (U. S.) 112, 16 L. Ed. 38; *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 37 L. Ed. 1113, 14 Sup. Ct. 127; *Fort Payne Furnace Co. v. Fort Payne Coal & Iron Co.*, 96 Ala. 472, 11 So. 439, 38 Am. St. Rep. 109; *Wallace v. Pierce-Wallace Pub. Co.*, 101 Iowa 313, 70 N. W. 216, 38 L. R. A. 122, 63 Am. St. Rep. 389; *Falmouth Nat. Bank v. Cape Cod Ship Canal Co.*, 166 Mass. 550, 44 N. E. 617; *Fort Wayne Elec. Corp. v. Franklin Elec. Light Co.*, 57 N. J. Eq. 7, 41 Atl. 217, *aff'd* 58 N. J. Eq. 579, 43 Atl. 1098; *Bell v. Wood*, 181 Pa. St. 175, 37 Atl. 201.

"It is apparently true that the class of receivership where the court has the most nearly complete scope of administration is that obtained under the familiar creditor's bill." *The General administration of equity*

receiverships of corporations, C. T. Payne, 31 Yale Law Journal 685.

⁸⁴ *Conro v. Gray*, 4 How. Pr. (N. Y.) 166; *Fletcher, Corporations*, secs. 5246, 5248.

⁸⁵ Where there was a judgment against a bridge company having no property except its franchise, it was held proper for a court of equity to appoint a receiver to collect the tolls and pay them into court for the purpose of paying the judgment. *Covington Drawbridge Co. v. Shepherd*, 21 How. (U. S.) 112, 16 L. Ed. 38. And see *Overton Bridge Co. v. Means*, 33 Neb. 857, 51 N. W. 240, 29 Am. St. Rep. 514.

⁸⁶ *Dodge v. Pyrolusite Manganese Co.*, 69 Ga. 665; *Cadogan v. Lyric Theatre*, [1894] 3 Ch. 338; *Etowah Min. Co. v. Wills Valley Min. & Mfg. Co.*, 106 Ala. 492, 17 So. 522.

⁸⁷ *Pond v. Framingham & L. R. Co.*, 130 Mass. 194; *Fort Payne Furnace Co. v. Fort Payne Coal & Iron*

is otherwise provided by statute, the mere fact that a corporation is insolvent does not constitute ground for the appointment of a receiver. It must further appear that there are assets which the creditor is entitled to have applied in satisfaction of his demand, and that they will probably be lost or fraudulently disposed of or wasted, unless a receiver is appointed, and that the creditor has no adequate remedy at law.⁸⁸ By statute in some states a receiver may be appointed if a corporation is insolvent or in imminent danger of insolvency.⁸⁹

Creditors of a corporation, even though they may have a lien by mortgage or otherwise, or a judgment, are not entitled to the appointment of a receiver, unless by express statutory provision, as a matter of absolute right. In the absence of a statute, and generally under the statutes, their application for a receiver is addressed to the sound discretion of the court, and, in exercising its power, the court should act with caution.⁹⁰ "The power of courts of chancery to appoint receivers," said Judge McDonald in a federal case, "is a discretionary power, to be exercised with great caution. To dispossess the owner of property of its possession before a final hearing, is a strong measure, not to be adopted but in a strong case. I think it should never be done unless, without it, the complainant would be in danger of suffering irreparable loss."⁹¹ But the later cases disclose greater liberality in the appointment of receivers.⁹²

In many states there are statutes providing for the appointment of receivers of corporation, and specifying the grounds, as when

Co., 96 Ala. 472, 11 So. 439, 38 Am. St. Rep. 109. See Fletcher, Corporations, sec. 5246.

⁸⁸ *Luhrig Collieries Co. v. Interstate Coal & Dock Co.*, 281 Fed. 265; *Lawrence Iron Works v. Rockbridge Co.*, 47 Fed. 755; *Doe v. Northwest Coal & Transportation Co.*, 64 Fed. 928; *Trust & Deposit Co. of Onondaga v. Spartanburg Water-Works Co.*, 91 Fed. 324; *Falmouth Nat. Bank v. Cape Cod Ship Canal Co.*, 166 Mass. 550, 44 N. E. 617; *Cook v. East Trenton Pottery Co.*, 53 N. J. Eq. 29, 30 Atl. 534; *Ft. Wayne Elec. Corp. v. Franklin Elec. Light Co.*, 57 N. J. Eq. 7, 41 Atl. 217, aff'd 58 N. J. Eq. 579, 43 Atl. 1098. See *Northwestern Nat. Bank of Minneapolis v. Mickleson-Shapiro Co.*, 134 Minn. 422, 159 N. W. 948.

⁸⁹ *Adler v. Campeche Laguna Corp.*, 257 Fed. 789; *Bruch v. National Guarantee Credit Corp.*, 13 Del. Ch. 180, 116 Atl. 738; *Kahle v. Industrial Loan & Investment Co.*, 103 Wash. 273, 174 Pac. 23.

⁹⁰ *Milwaukee & M. R. Co. v. Soutter*, 2 Wall. (U. S.) 510, 17 L. Ed. 900; *Pullan v. Cincinnati & C. Air-Line R. Co.*, 4 Biss. 35, 47, Fed. Cas. No. 11461; *Scattergood v. American Pipe & Construction Co.*, 247 Fed. 712; *Pusey & Jones Co. v. Hanssen*, 279 Fed. 488.

⁹¹ *Pullan v. Cincinnati & C. Air-Line R. Co.*, 4 Biss. 35, 47, Fed. Cas. No. 11461; *Boothe v. Summit Coal Min. Co.*, 55 Wash. 167, 104 Pac. 207, 19 Ann. Cas. 1255.

⁹² *Scattergood v. American Pipe & Construction Co.*, 247 Fed. 712.

the corporation has been dissolved, or is insolvent, or in imminent danger of insolvency, or has forfeited its corporate rights and in other cases where it has been customary to appoint receivers in equity. The grounds for appointment at the suit of a stockholder may be different from those at the suit of a creditor, for example, such dissensions as cause a deadlock in the affairs of the corporation or mismanagement, if there is no adequate remedy.⁹³ In the so-called "umbrella" receivership, a receiver is sometimes appointed in a friendly creditor's bill which is brought against the corporation in order that the court may take possession of all the assets and business of the defendant corporation. The main purpose is to declare a kind of moratorium against creditors to prevent them from breaking up the business during a temporary inability to meet maturing obligations. The receivership suspends the ordinary procedural rights of the creditors of the corporation in the collection of their debts. They cannot interfere with the assets in the possession of the receiver. Such a receivership may shelter the corporation against an impending financial storm and preserve its assets, organization and business until it is able to get the needed financial backing. "The purpose is to have the business of the corporation continue without interruption, and the aid of the court is invoked to prevent such interruption by the act of others."⁹⁴

Receiver as representative of creditors or corporation.—Some conflict exists as to the status of a receiver of a corporation. One line of decisions holds that the receiver stands in the shoes of the

⁹³ *Wheeler v. Badenhausen Co.*, 260 Fed. 991; *Goodwin v. Von Cotzhausen*, 171 Wis. 351, 177 N. W. 618; *Shelton v. Destrehan Mercantile Co.*, 151 La. 808, 92 So. 344; *O'Brien v. Lashar*, 274 Fed. 326; *Thoroughgood v. Georgetown Water Co.*, 9 Del. Ch. 84, 77 Atl. 720. See *Crow v. Bond & Mortgage Co. of Iowa*, — Iowa —, 209 N. W. 410. Appointment of receiver of corporation at suit of minority stockholders where corporation had ceased to function and fraud and neglect on the part of the management are shown in liquidating its assets, and the interests of the plaintiffs are in danger.

⁹⁴ *Scattergood v. American Pipe & Construction Co.*, 247 Fed. 712, 716 (moratorium as the end in view); *Du-*

rand & Co. v. Howard & Co., 216 Fed. 585, L. R. A. 1915 B 998; *Manhattan Rubber Mfg. Co. v. Lucey Mfg. Co.*, 5 Fed. (2d) 39; *Stokes v. Williams*, 226 Fed. 148. *Tardy's Smith on Receivers*, sec. 294; *Fletcher, Corporations*, secs. 5223, 5231, 5251; 11 *Cornell Law Quarterly*, 371.

Administration of Equity Receiverships of Corporations, C. T. Payne, 31 *Yale Law Journal* 685, 686, a corporate asset of great value is the "going concern" value, which may be preserved by a receivership. "In fact it is continuance of operation under full protection from attacks of individual creditors, which induces both owners and large creditors to submit the property of any foundering corporation to administration by

corporation and possesses no greater rights. Other cases hold that the receiver represents corporate creditors whose rights may be superior to those of the corporation, for example, in enforcing a subscription induced by fraud of the corporation where subsequent creditors have relied thereon.⁹⁵

Receivers' certificates.—With regard to public service companies there appears to be little difficulty or doubt as to the power of receivers to raise money by issuing receivers' certificates for the purpose of continuing the business, which take priority over existing incumbrances. Except for the preservation of the property the court will not authorize the receiver of a private corporation to issue receivers' certificates taking priority over existing liens.⁹⁶

a court of equity. It is this element which accounts for the amazing growth of this branch of equity jurisdiction within the last 50 years."

⁹⁵ *Marion Trust Co. v. Blish*, 170 Ind. 686, 84 N. E. 814, 85 N. E. 344, 18 L. R. A. (N. S.) 374n; *Graselli Chemical Co. v. Aetna Explosives Co.*, 252 Fed. 456, 460. A receiver is appointed in behalf of all parties. He is the representative of the creditors and also of the corporation and its stockholders.

Receiver is a *quasi-assignee* of the corporation. He represents not alone the corporation but the interests of

all the creditors and may sue to set aside corporate conveyances in fraud of creditors. *Keedy v. Sterling Electric Appliance Co.*, 13 Del. Ch. 66, 115 Atl. 359. See 11 Cornell Law Quarterly 371.

⁹⁶ *Oldroyd v. McCrea*, 65 Utah 142, 235 Pac. 580, 40 A. L. R. 230, 244n (power of receiver of private corporation to issue receivers' certificates); *Lockport Felt Co. v. United Box Board & Paper Co.*, 74 N. J. Eq. 686, 70 Atl. 980. See note, 9 Columbia Law Rev. 172; 64 Univ. Pennsylvania Law Rev. 399.

CHAPTER XIX.

SUCCESSION OF CORPORATIONS; REORGANIZATION AND CONSOLIDATION.

I. SUCCESSION IN GENERAL; PURCHASE AND TRANSFER.

§ 237. In general.—One corporation may succeed to the property and business of another corporation by a direct purchase and transfer, or by purchase of the same at a sale under execution, or under foreclosure of a mortgage, or other judicial sale, or by consolidation or merger.

When a corporation succeeds to the property, and business of another corporation, as by purchase and transfer, the succeeding corporation is not liable for the debts or on the general contracts of the old corporation, or for its torts; nor is the property in its hands liable therefor—

- (a) Unless there is an express agreement to pay or assume the same.
- (b) Or unless there are circumstances from which such an agreement may be implied.
- (c) Or unless the circumstances are such as to render the transfer a fraud upon the creditors of the old corporation.
- (d) Or unless the corporation is a mere continuance of the old corporation.
- (e) Or unless liability is imposed by statute.

The term “succession” with reference to corporations is used here broadly to designate any proceeding or transaction by which one corporation succeeds to or acquires the property, or property, franchises, and business of another corporation, or of a partnership or natural person. Succession may take place in various ways. It may take place by virtue of a direct sale and transfer of its property, or property and franchises, by one corporation to another, or by a natural person or partnership to a corporation. Or it may take place by a corporation’s purchasing the property, or property, franchises, and business of another corporation, at a

sale on execution against it, or at a sale under a decree foreclosing a mortgage executed by it, or other judicial sale; or, as will be seen in subsequent sections, by a consolidation of existing corporations.¹

§ 238. Liabilities of succeeding corporation.

As a general rule, a corporation, which has succeeded, by a valid purchase and transfer, to the property and franchises of another corporation, is not liable, merely by reason of its succession, for the general debts or on the general contracts of the other corporation. It is not liable at all for such debts or on such contracts, in the absence of a special agreement to pay or assume the same, nor is the property in its hands liable to be subjected to the same, in the absence of a valid lien thereon, unless it affirmatively appears that the transfer of the property and franchises of the other corporation constitutes, in fact or in law, a fraud upon its creditors, or the circumstances attending the creation of the new corporation, and its succession to the property and franchises of the old corporation, are such as to warrant a finding that it is in reality a mere continuation of the old corporation.² The purchase of the entire assets of another corporation is not sufficient to make the purchaser liable for the debts of the transferrer or seller; nor are the assets taken over subject to any equitable lien where the conveyance was in good faith, in the regular course of business for an adequate consideration. Statutory consolidation or merger or express or implied assumption of the liabilities would be necessary.³

¹ Post, § 240 et seq.; *Dunkley Co. v. California Packing Corp.*, 277 Fed. 996, 999 (a corporation may be the successor of another without either a merger or consolidation); 7 *Fletcher, Corporations*, secs. 4835, 4836.

The succession of one corporation to the property and business of another may result from: (1) the absolute transfer of the property and business for stock in the purchasing corporation or other consideration. (2) The lease of such property and business. (3) The consolidation of two or more corporations into a single new corporation. (4) The merger of one corporation into another. See *Noyes, Intercompany Relations* (2nd Ed.), sec. 1.

² *Davis v. Hemming*, 101 Conn. 713, 127 Atl. 514, 39 A. L. R. 133, 143n; *Austin v. Tecumseh Nat. Bank*, 49 Neb. 412, 68 N. W. 628, 35 L. R. A. 444, 59 Am. St. Rep. 543; *Ewing v.*

Composite Brake Shoe Co., 169 Mass. 72; *Luedecke v. Des Moines Cabinet Co.*, 140 Iowa 223, 118 N. W. 456, 32 L. R. A. (N. S.) 616; *Ozan Lumber Co. v. Davis Sewing Mach. Co.*, 284 Fed. 161; *Globe Oil Mills v. Van Camp Sea Food Co.*, 52 Cal. App. 781, 199 Pac. 864. See *Valley Bank v. Malcolm*, 23 Ariz. 395, 204 Pac. 207, 15 A. L. R. 1114n; *Fletcher, Corporations*, sec. 4751.

³ The fact that the successor corporation is composed of the same, or substantially the same stockholders as the old, does not of itself render the new corporation liable for claims against the old. *Racine Engine & Machinery Co. v. Confectioners' Machinery & Mfg. Co.*, 234 Fed. 876; *Atkinson v. Western Development Syndicate*, 170 Cal. 503, 150 Pac. 360; *Swing v. Empire Lumber Co.*, 105 Minn. 356, 117 N. W. 467; *McAlister v. American Ry. Exp. Co.*, 179 N. C.

The general rule that a corporation succeeding to the property and business of another corporation is not liable for the latter's general debts, or on its general contracts, does not apply where the succeeding corporation, by special agreement, assumes and promises to pay or perform such debts or contracts. In such a case it is liable by reason of its agreement or promise, for which its receipt of the property of the other corporation is a sufficient consideration.⁴ Nor does the rule apply where the transfer constitutes, either in fact or as a matter of law, a fraud upon the creditors of the other corporation as where the consideration is inadequate. In such a case, the creditors defrauded by the transfer may, in equity, follow the property into the hands of the new corporation, and subject it to the satisfaction of their claims, or hold the corporation liable to the extent of its value.⁵ Thus a transfer by a corporation of all its property and effects to another corporation, which has the effect of terminating its regular business and making it unable to pay its debts, without consideration except for the assumption of the debts by the transferee is invalid against creditors of the corporation. The creditors may in equity pursue the property that was their debtor's, either on the trust fund theory or better on the ground that it is a fraudulent conveyance.⁶

In the case of *Cole v. Millerton Iron Co.*,⁷ the plaintiff was a creditor of the National Mining Company. During the pendency

556, 103 S. E. 129, 15 A. L. R. 1090; *Ozan Lumber Co. v. Davis*, 284 Fed. 161; *Chase v. Michigan Tel. Co.*, 121 Mich. 631, 80 N. W. 717; *Burkholder v. Okmulgee Coal Co.*, 82 Okla. 80, 196 Pac. 679; *Valley Bank v. Malcolm*, 23 Ariz. 395, 204 Pac. 207; *American Ry. Exp. Co. v. Commonwealth*, 190 Ky. 636, 228 S. W. 433. Compare *Kentucky Distilleries & Warehouse Co. v. Webb's Ex'rs*, 181 Ky. 90, 203 S. W. 870.

⁴ *Episcopal Charitable Society v. Episcopal Church in Dedham*, 1 Pick. (Mass.) 372; *Friedenwald Co. v. Asheville Tobacco Works & Cigarette Co.*, 117 N. C. 544, 23 S. E. 490; *Island City Sav. Bank v. Sachtleben*, 67 Tex. 420, 3 S. W. 733; *Geiger v. Sanitary Farm Dairies*, 146 Minn. 235, 178 N. W. 501; *Ziemer v. C. G. Bretting Mfg. Co.*, 147 Wis. 252, 133 N. W. 139, Ann. Cas. 1912 D 1275; see 15 A. L. R. 1181n.

⁵ *Booth v. Bunce*, 33 N. Y. 139, 88 Am. Dec. 372 (where the managing

members of an embarrassed corporation unite in forming a new one under the general law, and then transfer to it the property of the former, a judgment creditor of the old corporation may levy execution upon the property, if it was transferred to the new one to hinder, delay and defraud creditors of the old); *Hibernia Ins. Co. v. St. Louis & New Orleans Transp. Co.*, 13 Fed. 516, 4 McCrary 432; *Grenell v. Detroit Gas Co.*, 112 Mich. 70, 70 N. W. 413; *Cole v. Millerton Iron Co.*, 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; *Blanc v. Paymaster Min. Co.*, 95 Cal. 524, 532, 30 Pac. 765, 29 Am. St. Rep. 149.

⁶ *Cole v. Millerton Iron Co.*, 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; *In re American Candy Mfg. Co.*, 256 Fed. 87, 88; *Pierce v. United States*, 255 U. S. 398, 65 L. Ed. 697, 41 Sup. Ct. 365.

⁷ 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615.

One who appropriates all the cor-

of an action to establish his claim, the company transferred all its property and assets to the defendant, the Millerton Iron Company, in consideration of the assumption of its debts. That company promptly executed a mortgage covering all of its property, so that when the plaintiff obtained his judgment and issued his execution he found nothing to levy upon. The defendant company gave no consideration except its promise to pay the indebtedness of the seller. This was held inadequate to make it a purchaser in good faith and for value as against creditors.

In *Ex parte Savings Bank of Rock Hill*,⁸ a South Carolina case, the Commercial Bank took over the assets of the Savings Bank upon an agreement to pay its debts and a certain sum to each stockholder. The transferee became insolvent before completing its undertaking. It was held that the transferee took the assets impressed with a trust, under the trust fund theory. A creditor of the Savings Bank was accordingly given a prior lien against those assets which could still be traced, in spite of the fact that the creditor had proved his claim and obtained a partial payment on the basis of the contract of assumption.

If the stockholders of a corporation organize another corporation, and transfer all the assets of the former to the latter, without adequate consideration or provision for paying the debts of the former, the transfer, irrespective of the actual intent of the parties, constitutes a fraud upon the creditors of the old corporation, and the new corporation is liable in equity for the debts of the old to the extent of the assets received by it, or the assets themselves may be followed by the creditors of the old corporation, so long as they have not passed into the hands of *bona fide* purchasers for value.⁹

porate assets to his individual use is personally liable for corporate debts to the extent of such assets. *Fulton Auto Supply Co. v. Sullivan*, 148 Ga. 347, 96 S. E. 875; *Martin v. Commonwealth*, 181 Ky. 212, 204 S. W. 84; *Louisville & N. R. Co. v. Nield*, 186 Ky. 17, 216 S. W. 62, noted in 29 Yale Law Journal 659.

⁸ 73 S. C. 393, 53 S. E. 614, 5 L. R. A. (N. S.) 520. It would seem that the decision was erroneous, in that the creditor, having proceeded against the new corporation on its personal liability by virtue of the assumption contract, had made his election to recognize the validity of the

transfer. He could not later attack the transfer as fraudulent or claim the proceeds as subject to a trust, an entirely inconsistent remedy. See also, *Fogg v. Blair*, 133 U. S. 534, 33 L. Ed. 721, 10 Sup. Ct. 338.

⁹ *Barry v. Interstate Refineries, Inc.*, 13 Fed. (2d.) 249 (the transfer by a Delaware company to a Virginia company of similar name of all its assets in exchange for stock thereof was *ultra vires* and fraudulent in law); *Hibernia Ins. Co. v. St. Louis & New Orleans Transp. Co.*, 13 Fed. 516, 4 McCrary, 432; *Montgomery Web Co. v. Dienelt*, 133 Pa. St. 585, 19 Atl. 428, 19 Am. St. Rep. 663;

The transferee of all the property of a debtor corporation is not personally liable by reason of the transfer even though the property may remain liable for the payment of the debts of the transferor corporation. To entitle a creditor to a personal judgment against the transferee there must have been an agreement, express or implied to assume the seller's debts, or a consolidation, or the purchasing corporation must be a mere continuation of the seller.¹⁰ If a corporation transfers all its assets to another corporation, and the purchaser pays in stock issued to the stockholders individually, leaving nothing in the hands of the corporation from which the creditor can collect his claim, the creditor may follow the assets as the transferee is not a good faith purchaser in the ordinary course of business.¹¹ A corporation cannot sell all its property and take in payment stock in a new corporation, under an arrangement that has the effect of distributing the assets of the vendor among its stockholders, to the exclusion and prejudice of its creditors. A company making such a purchase in consideration of an issue of its own stock to such stockholders, or to such corporation for distribution to its stockholders, takes the property subject to the rights of the creditors. It cannot be called a *bona fide* purchaser for value as against creditors. Stock is not an adequate substitute for the tangible assets of the old corporation.¹²

Metcalf v. Arnold, 110 Ala. 180, 20 So. 301, 55 Am. St. Rep. 24; *Cole v. Millerton Iron Co.*, 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; *Vicksburg & Y. C. Tel. Co. v. Citizens' Tel. Co.*, 79 Miss. 341, 30 So. 725, 89 Am. St. Rep. 656. When one corporation transfers all its property to another and ceases to do business, its liabilities are enforceable in equity against the property in the hands of the purchasing corporation, where it is not a *bona fide* purchaser for valuable consideration. A debtor cannot give away his property to the prejudice of a creditor, even if the claim is one for unliquidated damages.

¹⁰ *Ewing v. Composite Brake Shoe Co.*, 169 Mass. 72, 47 N. E. 241. If the stockholders of a corporation, together with others, form a new corporation which takes all the assets of the old corporation which has ceased to do business, and the new corporation does not assume to pay the debts of the old, the creditors have an equitable right to follow the

assets of the old; but they cannot sue at law against the new corporation, for there is no personal liability. See also, *Luedicke v. Des Moines Cabinet Co.*, 140 Iowa 223, 118 N. W. 456, 32 L. R. A. (N. S.) 616; 14A C. J. 890, 891; *Waterbury Gas Light Co. v. Walsh*, 228 Fed. 54; *Baker Motor Vehicle Co. v. Hunter*, 238 Fed. 894, 899; *Swing v. Empire Lumber Co.*, 105 Minn. 356, 117 N. W. 442.

¹¹ *Luedicke v. Des Moines Cabinet Co.*, 140 Iowa 223, 118 N. W. 456, 32 L. R. A. (N. S.) 616; *Hurd v. New York & C. Steam Laundry Co.*, 167 N. Y. 89, 60 N. E. 327.

¹² *Dalshheimer v. Graphic Arts Co.*, 86 N. J. Eq. 49, 97 Atl. 497; *Grennell v. Detroit Gas Co.*, 112 Mich. 70, 70 N. W. 413; *Sharples Co. v. Harding Creamery Co.*, 78 Neb. 795, 111 N. W. 783, 11 L. R. A. (N. S.) 863; *American Ry. Exp. Co. v. Commonwealth*, 190 Ky. 636, 228 S. W. 433; *American Ry. Exp. Co. v. Downing*, 132 Va. 139, 111 S. E. 265; *Jennings, Neff & Co. v. Crystal Ice Co.*, 128

The rule that a corporation is not personally liable for the debts of another corporation, to whose property and franchise it has succeeded, clearly does not apply where the corporations are, in law, the same concern. Where the charter of a corporation is merely amended, either by a special act or under a general law, there is no change in the identity of the corporate body,—no dissolution of one corporation and creation of another,—and the corporation, under the amended charter, is liable for all debts contracted by it before the amendment.¹³ The same is true where the charter of a corporation is merely extended or revived, or the corporation reorganized, without creating a new corporation.¹⁴ It seems to have been held that the general rule does not apply where the circumstances attending the creation of a new corporation, and its succession to the property, franchises, and business of another corporation, are such as to show that the new corporation is in reality, however it may be in law, a mere continuation of the old corporation; or, in other words, that, although technically, as a matter of law, a new corporation may be created, yet, if the old corporation ceases to exist, and all its assets and franchises are acquired by the new, which is in reality a reincarnation or continuation of the old, the new corporation is to be held to have impliedly assumed, and is liable upon, all the obligations of the old.¹⁵

Frequently a statute or charter authorizing a corporation to acquire the property and franchises of another corporation expressly provides that it shall be liable for the debts of the other

Tenn. 231, 159 S. W. 1088, 47 L. R. A. (N. S.) 1058. But compare *Swing v. Empire Lumber Co.*, 105 Minn. 356, 117 N. W. 467; *Ozan Lumber Co. v. Davis Sewing Mach. Co.*, 284 Fed. 161; *Byrne & Hammer Dry Goods Co. v. Willis-Dunn Co.*, 23 S. D. 221, 121 N. W. 620, 29 L. R. A. (N. S.) 589. Issuance of its stock by a corporation to members of an insolvent partnership in exchange for partnership assets, with which the corporation continues the business, is sufficient consideration so that the corporation is not liable to account for the assets to creditors of the partnership. See also, 29 Yale Law Journal 662.

¹³ *Trustees of University v. Moody*, 62 Ala. 389; *Johnston v. Crawley*, 25 Ga. 316, 71 Am. Dec. 173; *Dean v. La Motte Lead Co.*, 59 Mo. 523.

¹⁴ *St. Philip's Church v. Zion*

Presbyterian Church, 23 S. C. 297; *Miller v. English*, 21 N. J. Law 317; *Wilson v. Cheasapeake & O. R. Co.*, 21 Grat. (Va.) 654; *National Exch. Bank v. Gay*, 57 Conn. 224, 17 Atl. 555, 4 L. R. A. 343.

¹⁵ *Stanford Hotel Co. v. M. Schwind Co.*, 180 Cal. 348, 181 Pac. 780 (reorganized corporation as mere continuation of old, and liable on lease); *Reed Bros. v. First Nat. Bank of Weeping Water*, 46 Neb. 168, 64 N. W. 701; *Austin v. Tecumseh Nat. Bank*, 49 Neb. 412, 68 N. W. 628, 35 L. R. A. 444, 59 Am. St. Rep. 543; *Berry v. Kansas City, Ft. S. & M. R. Co.*, 52 Kan. 774, 36 Pac. 724, 39 Am. St. Rep. 381; *Higgins v. California Petroleum & Asphalt Co.*, 122 Cal. 373, 55 Pac. 155. See 15 A. L. R. 1114 note, on liability of corporation for debts of predecessor; 30 A. L. R. 558; 39 A. L. R. 143,

corporation. If a corporation acts upon and accepts the benefit of the statute, it thereby agrees to its terms and conditions, and cannot escape the liability imposed.¹⁶

§ 239. Change of state bank into a national bank.

Express provision is made, in the act of congress relating to national banking associations, for the reorganization of state banks into national banks.¹⁷ It is not very clear how a banking corporation organized under state laws, owing its existence and powers to such laws, and being purely a state corporation, can properly be said to be the same corporation when it has reorganized under the National Banking Act, and become a federal corporation, deriving its existence and powers solely from the laws of the United States, an entirely different sovereignty. However this may be in reason, it is settled, in so far as decisions can settle a question, that when a state bank is reorganized as a national bank under the act of congress, the reorganization does not change the identity of the corporation, but merely continues the same body under a different jurisdiction, and that, as a national bank, it takes all the assets possessed by it, including choses in action, and becomes subject to all the liabilities, including obligations under executory contracts, incurred by it as a state bank.¹⁸

II. CONSOLIDATION OF CORPORATIONS.

§ 240. In general.—The consolidation of corporation is a union of two or more existing corporations, under legislative authority, in a new corporation. By a merger one corporation is continued, and the other or others are merged in it.

When corporations are consolidated under legislative authority, the general rules are that—

¹⁶ *New Bedford R. Co. v. Old Colony R. Co.*, 120 Mass. 397; *Welsh v. First Division of St. Paul & P. R. Co.*, 25 Minn. 314. *Town of Plainview v. Winona & St. P. R. Co.*, 36 Minn. 505, 32 N. W. 745. See note in 15 A. L. R. 1171, on liability under statutory or constitutional provisions.

¹⁷ *Rev. St. U. S. § 5154*. No authority other than that conferred by the act of congress is necessary. *Casey v. Galli*, 94 U. S. 673, 24 L. Ed. 168.

¹⁸ *Michigan Ins. Bank v. Eldred*,

143 U. S. 293, 36 L. Ed. 162, 12 Sup. Ct. 450; *Metropolitan Nat. Bank v. Claggett*, 141 U. S. 520, 35 L. Ed. 841, 12 Sup. Ct. 60; *Coffey v. National Bank of Missouri*, 46 Mo. 140, 2 Am. Rep. 488; *City Nat. Bank of Poughkeepsie v. Phelps*, 97 N. Y. 44, 49 Am. Rep. 513; *Thorp v. Wegforth*, 56 Pa. St. 82, 93 Am. Dec. 789; *Western Reserve Bank v. McIntire*, 40 Ohio St. 528; *McCarthy v. Liberty Nat. Bank*, 73 Okla. 275, 175 Pac. 940, 7 A. L. R. 137. See 15 A. L. R. 1133 note.

- (1) The consolidated corporation acquires all the property, rights, powers, franchises, and privileges of the consolidating corporations, subject to the same burdens and restrictions which attached thereto in the hands of the consolidating corporations, under their charters.
- (2) And it is personally liable for the debts, the contracts, and the torts of the consolidating corporations.
- (3) These rules may be changed, however, subject to some limitations, by the statute authorizing the consolidation, or by the articles or agreement of consolidation.

When a consolidating corporation is dissolved by the consolidation, it cannot afterwards sue or be sued, and actions pending by or against it abate, unless there is statutory provision to the contrary. But if the right or liability passes to the consolidated corporation, it may be substituted as a party.

Corporations created by or under the laws of different states may be consolidated under concurrent legislation in each state, so as to be a consolidated company for the purpose of transacting business, etc., but technically, in contemplation of the law, there is a separate and distinct corporation in each state.

The consolidation of corporations means, generally, the combination of two or more corporations of the same or different states, by an agreement between them, under legislative authority, by which their rights, franchises, privileges, and property are united, and become the rights, franchises, privileges, and property of a single corporation, composed generally, although not necessarily, of the stockholders of the original corporations. The corporation resulting from the consolidation is called the consolidated corporation, and the original corporations are called the consolidating or constituent corporations. Ordinarily, the consolidating corporations are dissolved by the consolidation, and cease to exist, and an entirely new and distinct corporation is created as of the time of the consolidation;¹⁹ but this is not necessarily so. A consolidation

¹⁹ *Atlantic & Gulf R. Co. v. Georgia*, 98 U. S. 359, 25 L. Ed. 185; *Norton v. Union Traction Co.*, 183 Ind. 666, 110 N. E. 113, Ann. Cas. 1918 A 156; *McMahan v. Morrison*, 16 Ind. 172, 79 Am. Dec. 418; *People v. New York, C. & St. L. R. Co.*, 129 N. Y. 474, 29 N. E. 959, 15 L. R. A. 82; *Wolff v. Shreveport Gas, Electric Light Co.*, 138 La. 743, 70 So. 789, L. R. A.

1916 D 1138; *People ex rel. Shipton v. Dunleith & Dubuque Bridge Co.*, 322 Ill. 99, 152 N. E. 526, 533. By consolidation, the original corporations ceased to exist as separate, acting corporations. They may lie dormant, their property and franchises being held by the new consolidated corporation.

may be effected by the merger of one corporation in another, and continuance of the latter with the rights, franchises, privileges, and property of the former in addition to its own.²⁰ A "merger," however, where one of the constituent companies absorbs the others is frequently distinguished from a strict "consolidation" where all are merged in a new corporation.

§ 241. Power to consolidate or merge.

The consolidation or merger of corporations is not within the objects of a corporation, in the absence of provision therefor, and cannot be implied. It is well settled, therefore, that corporations cannot lawfully consolidate, however desirable and beneficial consolidation may be, unless the state has expressly authorized them to do so. Legislative authority is just as essential to a valid consolidation of existing corporations as it is to the creation of a corporation in the first instance.²¹ We have already considered the power of a majority of the stockholders of a corporation to consolidate against the dissent of the minority.²²

§ 242. Mode of effecting consolidation under legislative authority.

A statute authorizing two corporations to consolidate does not of itself effect a consolidation, without any action or agreement to that end by the corporations, but merely authorizes them to take proper action to bring about a consolidation.²³ If the statute merely confers the power to consolidate, without prescribing any mode of effecting consolidation, the consolidating corporations may agree upon any terms they may see fit, provided they are not unlawful.²⁴ But if the statute requires that the consolidation shall

²⁰ Central Railroad & Banking Co. v. Georgia, 92 U. S. 665, 23 L. Ed. 757; Meyer v. Johnston & Stewart, 64 Ala. 603; Chicago, S. F. & C. Ry. Co. v. Ashling, 160 Ill. 373, 43 N. E. 373. But see State v. Atlantic Coast Line R. Co., 202 Ala. 558, 81 So. 60 (strictly a merger is to be distinguished from a consolidation of two corporations into one new corporation. Merger means the absorption of one by another); 7 Fletcher, Corporations, sec. 4662; Collinsville Nat. Bank v. Esau, 74 Okla. 45, 176 Pac. 514.

²¹ Boyette v. Preston Motors Corp., 206 Ala. 240, 89 So. 746, 18 A. L. R. 1376; Pearce v. Madison & I. R. Co.,

21 How. (U. S.) 442, 16 L. Ed. 184; Clearwater v. Meredith, 1 Wall. (U. S.) 25, 17 L. Ed. 604; American Loan & Trust Co. v. Minnesota & N. W. R. Co., 157 Ill. 641, 42 N. E. 153; Black v. Delaware & R. Canal Co., 24 N. J. Eq. 455; Jones v. Rhea, 130 Va. 345, 107 S. E. 814.

²² Ante, §§ 175, 177; In re Interborough Consol. Corp., 277 Fed. 455. See note on necessity of consent of all stockholders to consolidation, in Ann. Cas. 1918 A 165. See also, 7 Fletcher, Corporations, sec. 4685.

²³ Mason v. Finch, 28 Mich. 282.

²⁴ Dimpfel v. Ohio & M. Ry. Co., 9 Biss. 127, Fed. Cas. No. 3918.

be effected in a certain mode or upon certain terms, its provisions must be substantially complied with, except in so far as they may be merely directory, or no consolidation *de jure* will take place; and, unless they are at least colorably complied with, there will not be even a *de facto* consolidation.²⁵

The usual steps in statutory consolidation or merger include the following:²⁶

(1) An agreement as to terms, often drawn up by the directors or a committee and issued to the shareholders of the corporations to be consolidated into a new corporation.

(2) Submission of the agreement to the stockholders of each company at a meeting thereof.

(3) Acceptance of the agreement by a majority vote, or by a two-thirds or three-quarters vote if required.

(4) Filing of the articles or agreement of consolidation in the office of the secretary of state, as in the case of a new incorporation and payments of fees.

§ 243. Dissolution of consolidating corporations, and creation of new corporation.

Since the rights of the parties will vary according to the effect of a consolidation upon the consolidating corporations, it is often important to determine whether a consolidation has the effect of dissolving the consolidating corporations, and creating a new corporation as of the time of the consolidation, or whether it merely continues the existence of one of them, and dissolves the others, or whether it dissolves any of them. Ordinarily, when corporations are consolidated under legislative authority, all of the consolidating corporations are dissolved and extinguished absolutely, so that they no longer exist for any purpose, and an entirely new and distinct corporation is created, as of the time of the consolidation, with the combined rights, franchises, privileges, and property of the consolidating corporations.²⁷

²⁵ Mansfield, C. & L. M. R. Co. v. Drinker, 30 Mich. 124; Tuttle v. Michigan Air Line R. Co., 35 Mich. 247; Mansfield, C. & L. M. R. Co. v. Brown, 26 Ohio St. 223.

²⁶ Bradford v. Frankfort, St. L. & T. R. Co., 142 Ind. 383, 40 N. E. 741, 41 N. E. 819; Dreyfus v. Old Colony Trust, 218 Mass. 546, 106 N. E. 154; 7 Fletcher, Corporations, sec. 4690.

²⁷ Clearwater v. Meredith, 1 Wall. (U. S.) 25, 17 L. Ed. 604; Shields v. Ohio, 95 U. S. 319, 24 L. Ed. 357; Atlantic & Gulf R. Co. v. Georgia, 98 U. S. 359, 25 L. Ed. 185; Keokuk & Western R. Co. v. Missouri, 152 U. S. 301, 38 L. Ed. 450, 14 Sup. Ct. 592; People v. New York, C. & St. L. R. Co., 129 N. Y. 474, 29 N. E. 959, 15 L. R. A. 82; Collinsville Nat. Bank v. Esau, 74 Okla. 45, 176 Pac.

But this is not necessarily the case. Whether a consolidation has this effect in any particular case depends upon the intention. As was stated in defining consolidation, the legislature may authorize a consolidation by the merger of one existing corporation in another, and continue the existence of the latter with the rights, franchises, privileges, and property of the former, in addition to its own. If such an intention appears, the merging corporation only is dissolved.²⁸

§ 244. Rights, powers, franchises, privileges, and property of consolidated corporation.

When corporations are consolidated, the rights, franchises, and privileges of the consolidated corporation depend upon the intention of the legislature as manifested by the statute authorizing the consolidation. The legislature may confer upon it, with the consent of the consolidating corporations,—which consent is given impliedly by entering into the consolidation,—all the rights, franchises, privileges, and property of the consolidating corporations, or it may withhold some of them, or it may add to them new rights, franchises, or privileges. A consolidated corporation has such powers only as are expressly or impliedly conferred by the statute authorizing the consolidation.²⁹

If there is no provision to the contrary in the statute or the agreement between the parties, the general rule, based upon the presumed intention of the legislature and the corporations, is that the consolidated corporation acquires by the consolidation all the rights, franchises, privileges, and property of the consolidating corporations, subject to the same burdens and restrictions which attached thereto in the hands of the consolidating corporations, respectively, under their charters.³⁰ Generally, by express pro-

514; *Adams v. Yazoo & M. Val. R. Co.*, 77 Miss. 194, 24 So. 200, 317, 28 So. 956, 60 L. R. A. 33.

Under some statutes constituent corporations are continued for purpose of enforcing claims of creditors. *Weaver v. Pacific Improvement Co.*, 198 N. Y. App. Div. 825, 191 N. Y. Supp. 541. See *Fletcher, Corporations*, secs. 4691, 4701, 4703, 4708.

²⁸ *Central Railroad & Banking Co. v. Georgia*, 92 U. S. 665, 23 L. Ed. 757; *Atlantic & Gulf R. Co. v. Georgia*, 98 U. S. 359, 25 L. Ed. 185; *Meyer v. Johnston*, 64 Ala. 603; *Chicago, S. F. & C. Ry. Co. v. Ashling*,

160 Ill. 373, 43 N. E. 373; *Berry v. Kansas City, Ft. S. & M. R. Co.*, 52 Kan. 759, 34 Pac. 805, 39 Am. St. Rep. 371; s. c., 52 Kan. 774, 36 Pac. 724, 39 Am. St. Rep. 381.

²⁹ *State v. Maine Cent. R. Co.*, 66 Me. 488.

³⁰ *Philadelphia, W. & B. H. R. Co. v. Maryland*, 10 How. (U. S.) 376, 13 L. Ed. 461; *Central Railroad & Banking Co. v. Georgia*, 92 U. S. 665, 23 L. Ed. 757; *Maine Cent. R. Co. v. Maine*, 96 U. S. 499, 24 L. Ed. 836; *New Orleans Gas-Light Co. v. Louisiana Light & Heat Producing & Mfg. Co.*, 115 U. S. 650, 29 L. Ed. 516, 6

vision of the statute or agreement of consolidation, or by implication, in the absence of provision to the contrary, the consolidated corporation succeeds to and may enforce the rights of the consolidating corporations under contracts made by them before the consolidation.³¹ Debtors of the original corporations are no longer indebted to them, but become the debtors of the new corporation.³²

§ 245. Burdens and liabilities of consolidated corporation.

The general rule is that, where corporations are consolidated under legislative authority, and the consolidated corporation takes the property and franchises of the consolidating corporations, it takes the same subject to precisely the same burdens which attached to them in the hands of the consolidating corporations.³³ It is undoubtedly within the power of the legislature, in conferring upon corporations authority to consolidate, to make the consolidated corporation liable on all the contracts of the consolidating corporations, and such liability is often imposed in express terms in statutes authorizing consolidation. On the other hand, the legislature may provide that the consolidated corporation shall not be liable on the contracts of the consolidating corporations, or that it shall be liable to a certain extent only,³⁴ though it cannot constitutionally deprive creditors of a consolidating corporation of the right to have a distribution of its property for the satisfaction of their claims, and to follow and subject it in equity in the hands of the consolidated corporation.³⁵

The difficulty in this connection has been in determining the liability of the consolidated corporation where the legislature has

Sup. Ct. 252; Louisville, N. O. & T. Ry. Co. v. Blythe, 69 Miss. 939, 11 So. 111, 16 L. R. A. 251, 30 Am. St. Rep. 599; Fisher v. New York Cent. & H. River R. Co., 46 N. Y. 644.

³¹ Brown v. Dibble's Estate, 65 Mich. 520, 32 N. W. 656; Lightner v. Boston & A. R. Co., 1 Lowell 338, Fed. Cas. No. 8343.

Where a statute authorizes corporations to consolidate, or consolidates them, and vests all their property in the consolidated corporation, including choses in action, the consolidated corporation may sue in its own name on choses in action of the consolidating corporations, although such right may not be given in express terms. University of Vermont & State Agricultural College v. Baxter's Estate, 42 Vt. 99.

³² Bishop v. Brainerd, 28 Conn. 289. And see Pennsylvania & N. W. R. Co. v. Harkins, 149 Pa. St. 121, 24 Atl. 175.

³³ Philadelphia, W. & B. R. Co. v. Maryland, 10 How. (U. S.) 376, 13 L. Ed. 461; Central Railroad & Banking Co. v. Georgia, 92 U. S. 665, 23 L. Ed. 757. See note 15 A. L. R. 1112, 1134; 30 A. L. R. 560n; 39 A. L. R. 146n.

³⁴ See Whipple v. Union Pac. Ry. Co., 28 Kan. 474; Shaw v. Norfolk County R. Co., 16 Gray (Mass.) 407, 410.

³⁵ Chicago, R. I. & P. R. Co. v. Moffitt, 75 Ill. 524; Wabash, St. L. & P. Ry. Co. v. Ham, 114 U. S. 587, 29 L. Ed. 235, 5 Sup. Ct. 1081.

made no express provision in regard thereto, and where there has been no express assumption of liability. In such case, according to the decided weight of authority, the consolidated corporation, if it takes the property of the consolidating corporations, impliedly assumes all their contract liabilities, express or implied, and may be sued thereon.³⁶ "For the purposes of answering for the liabilities of the constituent corporations," said the Indiana court, "the consolidated company should be deemed to be merely the same as each of its constituents, their existence continued in it, under the new form and name, their liabilities still existing as before, and capable of enforcement against the new company in the same way as if no change had occurred in its organization or name."³⁷

§ 246. Rights of creditors against consolidating corporations and their property.

If a consolidation is effected by the creation of an entirely new corporation, and dissolution of the consolidating corporations, creditors of the consolidating corporations cannot maintain an action against them after the dissolution, unless their existence is continued for the purpose of adjusting their liabilities, and of suits by or against them, for the creditors of a corporation cannot prevent consolidation or dissolution, and a corporation cannot be sued after its dissolution. The only remedy of their creditors is either against the consolidated corporation, or, in equity, against the assets of the consolidating corporations in its hand. That the creditors of the consolidating corporations may follow their assets into the hands of the consolidated corporation in such a case can admit of no question; and they cannot be deprived of this right by the consolidation agreement or by the statute authorizing the con-

³⁶ *Mt. Pleasant v. Beckwith*, 100 U. S. 519, 25 L. Ed. 699; *Pullman's Palace Car Co. v. Missouri Pac. Ry. Co.*, 115 U. S. 587, 29 L. Ed. 499, 6 Sup. Ct. 194; *Warren v. Mobile & M. R. Co.*, 49 Ala. 582; *Montgomery & West Point R. Co. v. Boring*, 51 Ga. 582; *Western Union R. Co. v. Smith*, 75 Ill. 496; *Louisville, N. A. & C. Ry. Co. v. Boney*, 117 Ind. 501, 20 N. E. 432, 3 L. R. A. 435; *Berry v. Kansas City, Ft. S. & M. R. Co.*, 52 Kan. 759, 34 Pac. 805, 39 Am. St.

Rep. 371; s. c., 52 Kan. 774, 36 Pac. 724, 39 Am. St. Rep. 381; *Mississippi Valley R. Co. v. Chicago, St. L. & N. O. R. Co.*, 58 Miss. 846; *Boardman v. Lake Shore & M. S. Ry. Co.*, 84 N. Y. 157; *Connecticut Co. v. New York, N. H. & H. R. Co.*, 94 Conn. 13, 107 Atl. 646.

³⁷ *Indianapolis, C. & L. R. Co. v. Jones*, 29 Ind. 465, 95 Am. Dec. 654; see 40 *Harvard Law Rev.* 1012; 11 *Minnesota Law Rev.* 372.

solidation, unless the authority to consolidate was given before they became creditors.³⁸

In *Irvine v. New York Edison Co.*,³⁹ it is held that when one corporation is merged into another, under the New York Stock Corporation Law, a creditor of the merged corporation cannot sue the possessor corporation as for a debt, since there is no provision in the statute making it liable as upon a contract (where there is no assumption). But the reservation in the statute that the merger should be without prejudice to the creditors gives them the right to follow the assets and take the property upon execution issued on a judgment against the debtor corporation or upon a creditor's bill. Although the merged corporation became extinct for most purposes, it can still be sued under the statute preserving rights of creditors.

Where a consolidating corporation is not dissolved by the consolidation, as in the case of consolidation by merger of one corporation in another, which continues in existence, or where the existence of consolidating corporations is continued for the purpose of adjusting their liabilities, creditors of the undissolved consolidating corporation may sue it and recover judgment on their claims notwithstanding the consolidation, and may then enforce the judgment against its property in the hands of the consolidated corporation.⁴⁰

Joinder of old and new corporations in same suit.—In a Virginia case,⁴¹ the plaintiff sued the old corporation and the consolidated corporation which had assumed its liabilities in a single action for an injury done him by the old company. The declara-

³⁸ *Chicago, R. I. & P. R. Co. v. Moffitt*, 75 Ill. 524; *New Bedford R. Co. v. Old Colony R. Co.*, 120 Mass. 397; *Market St. Ry. Co. v. Hellman*, 109 Cal. 571, 42 Pac. 225. And see *Compton v. Wabash, St. L. & P. Ry. Co.*, 45 Ohio St. 592, 16 N. E. 110, 18 N. E. 380; *Morrison v. American Snuff Co.*, 79 Miss. 330, 30 So. 723, 89 Am. St. Rep. 598 (a corporation created by the consolidation of several corporations holds the assets received from each of the constituent corporations in trust subject to the claims of the creditors of the original corporations. The creditors' remedy may be an action at law against the consolidated company, to be satisfied out of the property received by it

from the debtor, or the assets may be followed in equity as a trust fund); *Fletcher, Corporations*, secs. 4805, 4806; *I Thompson, Corporations* (2nd Ed.), sec. 6082.

³⁹ 207 N. Y. 425, 101 N. E. 358, Ann. Cas. 1914 C 441; *Syracuse Lighting Co. v. Maryland Casualty Co.*, 226 N. Y. 25, 31, 122 N. E. 723.

⁴⁰ In *re Utica National Brewing Co.*, 154 N. Y. 268, 48 N. E. 521; *Platt v. New York & B. R. Co.*, 26 Conn. 544; *Chicago, S. F. & C. Ry. Co. v. Ashling*, 160 Ill. 373, 43 N. E. 373.

⁴¹ *Langhorne v. Richmond Ry. Co.*, 91 Va. 369, 22 S. E. 159. *Op. Citizens' St. R. Co. v. Shepherd*, 30 Ind. App. 193, 65 N. E. 765.

tion stated a cause of action against both companies. Upon demurrer for misjoinder of causes of action and parties defendant, it was held that both corporations could not be joined in the same action. They are not jointly liable. One is liable in tort for committing the injury. The other is liable by reason of consolidation or assumption of liability.

Extent of liability.—It is frequently stated that the liability of the successor corporation is limited to the value of the assets received from the constituent companies it succeeds.⁴² But this question cannot be regarded as being settled. Such a limitation would depend on whether the new consolidated corporation is personally liable as by a contract to assume the debts of its constituents, or by statute, or whether the liability of the new corporation is simply a method by which the creditors of the old are allowed to follow its assets and enforce its liability. In case of absorption of the business and assets of one corporation by another by transfer, where the liability is based upon the "trust fund doctrine," the extent of liability is determined by the value of the property received as in the case of a fraudulent conveyance.⁴³

§ 247. Consolidation of corporations of different states.

The effect of a consolidation of corporations created by different states under concurrent legislation in the several states is not to create a single corporation in all the states, as in the case of a consolidation of corporations created by the same state, but to create a separate corporation in each state. For the purpose of conducting operations, there is, in a sense, a consolidated corporation, for all the corporations are under one management, and may have precisely the same powers, and may consist of the same stockholders; but in contemplation of the law, there is a distinct corporation in each state, owing its existence to the law of that state, and that state only. This is necessarily so by reason of the fact that the laws of a state cannot operate beyond its territorial limits, and therefore cannot create or aid in creating a corporation in another state.⁴⁴ In accordance with this view, it has repeatedly been

⁴² See note, 15 A. L. R. 1148; 8 Thompson, Corporations (2nd Ed.), sec. 6085. See also *Okmulgee Window Glass Co. v. Frink*, 260 Fed. 1150.

⁴³ See note, 15 A. L. R. 1150.

⁴⁴ *Vaughan v. Nashville, C. & St. L. Ry.*, 192 Ky. 137, 232 S. W. 411, 18

A. L. R. 124 (two or more states cannot create a single corporation); *J. W. Wells Lumber Co. v. Menominee River Boom Co.*, 203 Mich. 14, 168 N. W. 1011, (on consolidation of corporations of different states, a separate corporation is created in each state);

held that, where corporations created by different states are consolidated by concurrent legislation in the several states, the consolidated corporation is to be considered as a citizen and resident of each state, for the purpose of suits in the federal courts, and for many other purposes. In each state it is there regarded as a domestic corporation.⁴⁵

Conduct of business.—Meetings, contracts, etc.—Though such a corporation is thus technically a distinct corporation in each state, and a resident of each state, and owes its existence and powers in each state to the laws of that state only, yet as it is under one management, consists of the same stockholders, and has the same powers in each state, it is in effect a consolidated corporation for the purpose of conducting its business and entering into contracts, etc.⁴⁶ The consolidated corporation has a domicile in each state, and it or its shareholders can, in the absence of provision to the contrary, hold meetings and transact corporate business in any of the states, so as to bind the corporation as to its property everywhere.⁴⁷ Contracts made by the officers of the consolidated corporation, and mortgages executed by them upon its property in all the states, which purport to be made or executed by the consolidated corporation, will be regarded as made by the corporation of each state, and will be given the same effect as if the consolidated company were, in law as well as in reality, a single corporation.⁴⁸

Patch v. Wabash R. Co., 207 U. S. 277, 52 L. Ed. 204, 28 Sup. Ct. 80, 12 Ann. Cas. 518. See also, *Ohio & M. R. Co. v. Wheeler*, 1 Black (U. S.) 286, 17 L. Ed. 130; *Baltimore & O. R. Co. v. Harris*, 12 Wall. (U. S.) 65, 20 L. Ed. 354; *Racine & M. R. Co. v. Farmers' Loan & Trust Co.*, 49 Ill. 331, 95 Am. Dec. 595; *Chicago & N. W. Ry. Co. v. Auditor General*, 53 Mich. 79, 18 N. W. 586; *In re St. Paul & N. P. Ry. Co.*, 36 Minn. 85, 30 N. W. 432; *McGregor v. Erie Ry. Co.*, 35 N. J. Law 115; *Sage v. Lake Shore & M. S. Ry. Co.*, 70 N. Y. 220; *Mobile & O. R. Co. v. Barnhill*, 91 Tenn. 395, 19 S. W. 21, 30 Am. St. Rep. 889. And see ante, § 7; *Beale Corporations of two states*, 4 Columbia Law Rev. 391, 400; *Fletcher, Corporations*, secs. 4814, 4820, 4823.

⁴⁵ *Vermont Valley R. Co. v. Connecticut River Power Co.*, — Vt. —, 133 Atl. 367. A corporation formed by consolidation of constituent cor-

poration under the authority of the different states creating them, is a citizen of each state for the purpose of jurisdiction and it may be sued as a domestic corporation. See ante, § 7.

⁴⁶ *Graham v. Boston, H. & E. R. Co.*, 118 U. S. 161, 30 L. Ed. 196, 6 Sup. Ct. 1009; *Racine & M. R. Co. v. Farmers' Loan & Trust Co.*, 49 Ill. 331, 95 Am. Dec. 595.

⁴⁷ *Graham v. Boston, H. & E. R. Co.*, 118 U. S. 161, 30 L. Ed. 196, 6 Sup. Ct. 1009. See also, *Ohio & M. Ry. Co. v. People ex rel. Hanna*, 123 Ill. 467, 14 N. E. 874; *Guinault v. Louisville & N. R. Co.*, 41 La. Ann. 571, 6 So. 850; *Covington & C. Bridge Co. v. Mayer*, 31 Ohio St. 319; *Racine & M. R. Co. v. Farmers' Loan & Trust Co.*, 49 Ill. 331, 95 Am. Dec. 595.

⁴⁸ *Racine & M. R. Co. v. Farmers' Loan & Trust Co.*, 49 Ill. 331, 95 Am. Dec. 595.

III. REORGANIZATION.

§ 248. Reorganization without foreclosure by agreement.

The reorganization of a corporation may be brought about in various ways, and under varying circumstances.⁴⁹ It may be brought about in pursuance of an agreement of all the parties, without any foreclosure, or by transfer of the property to a new corporation, or by purchasing the property at a foreclosure sale, and organizing a new corporation to take the same and continue the business. In some states, elaborate provisions for reorganization of corporations have been made by statute.

Reorganization of a corporation which has issued bonds secured by a mortgage, and which has become embarrassed and unable to pay the interest, is sometimes effected by an agreement with the stockholders and bondholders, under which the stock and bonds, or bonds only, of the company are readjusted, so as to enable the company to continue business without a foreclosure of the mortgages on its property, the stockholders perhaps taking new stock, and the bondholders surrendering their bonds, and taking new bonds differing from the old bonds as to amount, rate of interest, or priority, etc. Such a reorganization is voluntary, and requires the assent of all the parties interested. If any stockholder or bondholder refuses to come into the arrangement, he cannot be compelled to do so. He may insist upon his rights as a stockholder or bondholder, and prevent any reorganization which will affect the rights secured to him by his contract with the company.⁵⁰

A bondholder has a right to refuse to come into the agreement, and to insist upon payment of his bonds, or upon a foreclosure of

⁴⁹ The term "reorganization" may be applied to a change of financial structure or plan by which the stocks and bonds issued to represent rights against the corporate property are readjusted as to amount, income or priority, as by allowing new stock or bonds to have priority over the old.

"Reorganization" is generally used to indicate the formation of an entirely new corporation, for the purpose of purchasing the property of another corporation, and superseding it in business, without incurring any liability to its creditors." Morawetz, *Corporations*, sec. 811. This is frequently done by the bondholders, creditors and stockholders after the foreclosure of a mortgage or a judi-

cial sale. The new corporation carries on the business of the old upon a new capital, free from its debts and obligations, except so far as expressly assumed or represented by new securities. See Cook, *Corporations* (8th Ed.), sec. 883. Cook classifies the different modes of reorganization as follows: (1) Consent to scaling down of securities. (2) Reorganization by disposing of the assets without a judicial sale. (3) Reorganization by court decree without sale. (4) Reorganization on foreclosure or insolvency sale. (5) Reorganization in bankruptcy court.

⁵⁰ *Hollister v. Stewart*, 111 N. Y. 644, 19 N. E. 782; *Lake St. El. R. Co. v. Ziegler*, 99 Fed. 114. See P.

the mortgage by which they are secured, and if the stockholders and other bondholders proceed with a reorganization without his consent, he will not be bound thereby.⁵¹ Any party, however, whether a stockholder or a bondholder or other creditor or the corporation itself, who enters into a valid agreement for the purpose of reorganization, is bound thereby, and cannot repudiate the same, and insist upon his original rights in violation of its terms, either before or after the agreement has been carried out.⁵²

Transfer of property to a new corporation.—A reorganization is sometimes effected, without foreclosure of a mortgage, by transferring all the property of the corporation to a new corporation. The transfer, of course, cannot deprive nonassenting bondholders or others having a lien upon the property of the right to enforce the same; nor can it prevent unsecured creditors from following the property into the hands of the transferee.⁵³ As against non-assenting creditors the sale is voidable in equity, regardless of motive. They cannot be compelled to accept a change of debtors against their will.⁵⁴ If a majority of the stockholders of a corporation authorize a sale of its property for the purpose of a reorganization, they cannot themselves, directly or indirectly, purchase at the sale to the exclusion or prejudice of other stockholders.⁵⁵

D. Cravath, *Reorganization of corporations, in Some legal phases of corporate financing*, by Stetson and others, p. 209.

⁵¹ Hollister v. Stewart, 111 N. Y. 644, 19 N. E. 782; Philadelphia & Reading R. Co. v. Love, 125 Pa. St. 488, 17 Atl. 455.

⁵² Dester v. Ross, 85 Mich. 370, 48 N. W. 530; First Nat. Bank of Chattanooga v. Radford Trust Co., 80 Fed. 569.

Agreements by which stockholders and creditors of a corporation in receivership deposit their claims and securities with a reorganization committee are binding contracts between the committee and the depositor. The depositor cannot withdraw his claim or security except in accordance with the contract. Otherwise the work of such committees would go for nothing. *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875; *Industrial & General Trust v. Tod*, 180 N. Y. 215, 73 N. E. 7.

⁵³ Ante, § 238. Liability of reor-

ganized corporation for debts of predecessor, see 15 A. L. R. 1112, 1139, 1144, 1151; 30 A. L. R. 561; 39 A. L. R. 146.

⁵⁴ Grenell v. Detroit Gas Co., 112 Mich. 70, 70 N. W. 413. See *North-eastern Pac. Ry. Co. v. Boyd*, 228 U. S. 482, 57 L. Ed. 931, 33 Sup. Ct. 554; *Fletcher, Corporations*, secs. 4984, 4985.

⁵⁵ *Meeker v. Winthrop Iron Co.*, 17 Fed. 48; *Mason v. Pewabic Min. Co.*, 133 U. S. 50, 33 L. Ed. 524, 10 Sup. Ct. 224; *Farmers' Loan & Trust Co. v. New York & N. Ry. Co.*, 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689; *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320, 30 N. E. 667, 33 Am. St. Rep. 315; 7 *Fletcher, Corporations*, sec. 4866.

Eagleson v. Pacific Timber Co., 270 Fed. 1008: "Where the reorganization of a corporation, effected in part by a sale of its assets to a new corporation, leaves an interest in the stockholders of the old company, or provides for the acquisition by them of an interest in the new company,

Nor can any one or more of the directors or other managing officers of the corporation purchase at such a sale. If they do so, the sale is voidable at the suit of any stockholder.⁵⁶

§ 249. Reorganization in connection with foreclosure and sale under mortgage or deed of trust and other judicial sales.

Corporations are frequently reorganized by procuring a foreclosure and sale under a mortgage or deed of trust given by it to secure its bonds, purchasing its property and franchises at the sale, and causing the same to be transferred to another corporation organized for the purpose by the stockholders or bondholders, or both, or by some of them. When a railroad company or other corporation, which has issued bonds and given a mortgage or deed of trust to secure the same, becomes embarrassed and unable to pay the interest or principal, it is often advisable, and perfectly legal, for the bondholders, or a part of them, to formulate some scheme for reorganization of the corporation after a sale of the property under a decree foreclosing the mortgage or deed of trust, or under a power of sale given in the same. They may enter into an agreement for this purpose, appoint a committee or other agent to represent them, to purchase the property at the foreclosure sale for their benefit, to form a new corporation, and to transfer the property to it in return for stock or bonds, or both to be issued to them by it in accordance with the agreement. Such an agreement, and the purchase in pursuance thereof, are not only legal, but are regarded with favor by the law.⁵⁷

In *Re Prudential Outfitting Co., of Delaware, Inc.*,⁵⁸ Learned Hand, J. gives the following description of the conventional

the right to participate in such interest must be equally favorable to all stockholders of the same class."

⁵⁶ See *Hoffman Steam Coal Co. v. Cumberland Coal & Iron Co.*, 16 Md. 456; *Cumberland Coal & Iron Co. v. Sherman*, 30 Barb. (N. Y.) 553.

⁵⁷ See *Shaw v. Little Rock & Ft. S. R. Co.*, 100 U. S. 605, 25 L. Ed. 757; *Robinson v. Philadelphia & R. R. Co.*, 28 Fed. 340; *Gates v. Boston & N. Y. Air Line R. Co.*, 53 Conn. 333, 5 Atl. 695; *Child v. New York & N. E. R. Co.*, 129 Mass. 170; *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875, 43 A. L. R. 1035, 1043 note. Right of bondholder, stockholder or

creditor to withdraw his claim from reorganization committee. Security holders cannot recede from contracts.

The stockholders of the old company, if they act in good faith, may organize a new corporation to buy the property of the insolvent one; and when the new corporation purchases at the judicial sale it will take the property free from the obligation of the debts and contracts of the old corporation, unless expressly assumed. *Warren Co. v. A. L. Black Coal Co.*, 85 W. Va. 684, 102 S. E. 672, 12 A. L. R. 1083. See also, 4 Cook, Corporations, secs. 410, 490; 7 Fletcher, Corporations, sec. 4988.

⁵⁸ 250 Fed. 504, 506.

process of reorganization: "Under it a new corporation is formed by those creditors who wish to join the plan, and who assign their claims to it or to their committee. This corporation or committee may then make a cash bid, which it may in part pay by allowing a proportionate credit upon the assigned claims. The dissenting creditors must be paid in cash their own proportion of the bid, which is their inviolate right. They are protected by the power of the court to fix an upset price, aided in the case of bankruptcy by the statute itself."

When a court in a receivership has possession of large properties of a corporation, where the rights and relations of the creditors and the stockholders are very complicated, a sale of the property, disconnected from a plan of reorganization is likely to prove disastrous. Hence it is that courts of equity conserve the property in their custody until a sale can be had as a step in reorganization, which makes possible the continuance of the enterprise and avoids the sacrifice of values. In reorganization creditors and security owners can accomplish by united action what they could not achieve alone. To throw the corporation into bankruptcy would mean complete disaster and liquidation at a sacrifice instead of a continuance of the enterprise.⁵⁹

If a corporation is unable to meet its obligations, a foreclosure suit or a creditor's bill may be brought in equity and a receiver appointed. Self-constituted protective committees of the various classes of creditors and stockholders are formed who seek the cooperation of other holders and negotiate as to the terms of a reorganization. When the property is sold the reorganization committee buys in the assets, and pays for them in claims. It pays actual money only to the extent of furnishing the cash distributive share, as fixed by the sale price, to those creditors who do not assent to the reorganization and take securities in the new corporation. "The new corporation thus becomes vested with the assets of the insolvent corporation and issues securities to the

⁵⁹ *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875, 43 A. L. R. 1035.

In *United States & Mexican Trust Co. v. United States & Mexican Trust Co.*, 250 Fed. 377, Hook, J., says: "It is much better practice for a reorganization committee to formulate their plan for reorganization before

the final decree and sale. That course enables the security holders to know, while a choice might be of value, how they would fare by accepting or rejecting it, and it gives the court in charge of the case an opportunity to hear the objections of those dissenting and to afford them such relief as equity may require."

creditors and stockholders of the old company and to investors of new capital, pursuant to the terms of the reorganization plan. Business goes on without a moment's interruption."⁶⁰

Who may purchase at foreclosure sale.—In the absence of statutory restrictions, any person may purchase the property of a corporation at a foreclosure sale, provided his relation to the parties in interest, and the circumstances attending the purchase, are not such as to make the purchase a breach of trust. There is nothing to prevent the bondholders from purchasing, or a part of them, provided there is no fraud upon the others. They may appoint a person or committee to purchase for them, and this is the usual course.⁶¹ If the bondholders are to take over a railroad or other property on default in payment of the bonds, there must be some form of valuing the property to ascertain whether there is any surplus "equity" for general creditors or stockholders. This is accomplished by the foreclosure sale. Since there is no possibility of real competitive bidding for a great system of national transportation, the court is accustomed to fix an "upset price," which is the minimum at which the property can be bought in by the majority bondholders.^{61a}

A majority of the stockholders of a corporation cannot combine to procure a foreclosure and sale, and a reorganization, to the prejudice of the other stockholders, for the majority occupy a fiduciary relation towards the minority, and it is their duty to see that the best possible price is obtained at the sale. Collusion on their part will entitle an injured stockholder to sue to set the sale aside.⁶² A majority of the stockholders, however, may purchase

⁶⁰ Rosenberg, A new scheme of reorganization, 17 Columbia Law Rev. 523, 526; Corporate reorganization and the Federal Court, Rosenberg, Swaine & Walker, p. 6.

⁶¹ Allen v. Gillette, 127 U. S. 589, 32 L. Ed. 271, 8 Sup. Ct. 1331; Pacific R. Co. v. Ketchum, 101 U. S. 289, 25 L. Ed. 932; James v. Cowing, 82 N. Y. 449; Zebbley v. Farmers' Loan & Trust Co., 139 N. Y. 461, 34 N. E. 1067.

^{61a} Weiner, Conflicting functions of the upset price in a corporate reorganization, 27 Columbia Law Rev. 132; Guaranty Trust Co. of New York v. Chicago, M. & St. P. Ry. Co., 15 Fed. (2d) 434, 442.

⁶² See Ribon v. Chicago, R. I. & P.

R. Co., 16 Wall. (U. S.) 446, 21 L. Ed. 367; Farmers' Loan & Trust Co. v. New York & N. R. Co., 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689; Mason v. Pewabic Min. Co., 133 U. S. 50, 33 L. Ed. 524, 10 Sup. Ct. 224; Hanley v. Balch, 94 Mich. 315, 53 N. W. 954; Southern Pac. Co. v. Bogert, 250 U. S. 483, 63 L. Ed. 1099, 39 Sup. Ct. 533. Where the majority shareholders of a corporation, through a reorganization obtained all the shares of a new corporation, successor to the old, the minority may compel the majority to make *pro rata* distribution of the fruits of its control on equal terms among the minority.

at the sale, by themselves or through an agent, and reorganize, if they do so in good faith, and without taking any undue advantage.⁶³

Any agreement that the stockholders of a corporation, whose property is to be sold under a mortgage, shall share in the proceeds of the sale, for the purpose of preventing them from resisting the foreclosure, is a fraud upon the general creditors of the corporation, and is void.⁶⁴ But the stockholders of a corporation commit no fraud against creditors by becoming stockholders in the new corporation by an arrangement entered into after the foreclosure,⁶⁵ or by purchasing stock therein, and paying full value therefor, although it may be less than par.⁶⁶

Rights of unsecured creditors.—The only right which the unsecured creditors have against a corporation, which can interfere with a reorganization, is the right to have all the assets of the corporation applied in payment of their claims, after the satisfaction of debts secured by lien thereon. It follows that when the property of a corporation is about to be sold on foreclosure of a mortgage thereon, an agreement between the bondholders, or bondholders and stockholders, to unite in purchasing the property at the sale, and in organizing a new corporation to take the same, is not a fraud upon the unsecured creditors of the corporation, so as to entitle them to enforce their claims against the new corporation.⁶⁷

Right to participate in reorganization.—Any party to a reorganization agreement, whether a bondholder, stockholder, or general creditor, or any person who is thereby offered the privilege of coming in, has a right to be admitted, and to participate in the benefits of the organization, provided he applies to come in within the time fixed by the agreement or offer, and complies or offers to comply with the prescribed terms or conditions. If the right is

⁶³ *Pewabic Min. Co. v. Mason*, 145 U. S. 349, 36 L. Ed. 732, 12 Sup. Ct. 887; *Carter v. Ford Plate Glass Co.*, 85 Ind. 180.

⁶⁴ *Chicago, R. I. & P. R. Co. v. Howard*, 7 Wall. (U. S.) 392, 19 L. Ed. 117. See *Northern Pac. Ry. v. Boyd*, 228 U. S. 482, 57 L. Ed. 931, 33 Sup. Ct. 554.

⁶⁵ *Stewart's Appeal*, 72 Pa. St. 291.

⁶⁶ *Ferguson v. Ann Arbor R. Co.*, 17 N. Y. App. Div. 336, 45 N. Y. Supp. 172.

⁶⁷ *In re Pennsylvania Transp. Co.'s Appeal*, 101 Pa. St. 576. And see ante, § 238; post, § 250.

denied him, he may specifically enforce the same in the courts,⁶⁸ or he may maintain an action to recover the damages sustained by reason of the refusal.⁶⁹

On the other hand, neither stockholders, bondholders, nor general creditors of the corporation can claim any rights in the new organization except such as may be given them by the reorganization agreement. Those who are not parties to this agreement can claim no interest in the new company, nor sue to set the sale and reorganization aside, unless they have been fraudulently or wrongfully excluded.⁷⁰ It is usual and lawful to insert in an agreement for reorganization a provision that stockholders, bondholders, or other creditors who are permitted to come into the reorganization shall do so, if at all, within a certain time, and, if they refuse or fail to do so, they can claim no right to participate.⁷¹

§ 250. Rights and remedies of creditors against new corporation after foreclosure.

We have already considered the question as to the liability of the new corporation, after reorganization or transfer generally, for the debts and contracts of the old corporation.⁷² We shall here consider the question of the right of creditors to follow the property of the old corporation into the hands of the purchaser at a foreclosure or judicial sale, and the limitations established in the *Boyd* case on the admission of the stockholders to participate in reorganized corporation without provision for creditors.

The purchase at a foreclosure sale of the property of a large insolvent corporation usually requires such great outlay of capital that a very limited market for the property is found. For this reason the usual practice has been for bondholders to form a new corporation to buy in the property on foreclosure, paying for the property in bonds. In order to secure the new capital needed, stockholders of the old corporation are given stock in the new corporation for stock held in the old on paying an "assessment"

⁶⁸ *Cornell v. Utica, I. & E. R. Co.*, 61 How. Pr. (N. Y.) 184; *Marie v. Garrison*, 83 N. Y. 14; *Wetmore v. St. Paul & P. R. Co.*, 5 Dill. 531, 3 Fed. 177.

⁶⁹ *Harris v. Davis*, 44 Fed. 172; *Reading Trust Co. v. Reading Iron Works*, 137 Pa. St. 282, 21 Atl. 169, 170.

⁷⁰ *Shaw v. Little Rock & Ft. S. R. Co.*, 100 U. S. 605, 25 L. Ed. 757;

Gates v. Boston & N. Y. Air Line R. Co., 53 Conn. 333, 5 Atl. 695; *In re Pennsylvania Transp. Co.'s Appeal*, 101 Pa. St. 576.

⁷¹ *Bound v. South Carolina R. Co.*, 78 Fed. 49, aff'g 71 Fed. 53; *Thornton v. Wabash Ry. Co.*, 81 N. Y. 462; *Vatable v. New York, L. E. & W. R. Co.*, 96 N. Y. 49.

⁷² *Ante*, § 238.

of less than par value. It frequently occurs that unsecured creditors object to the plan and insist on a provision for their benefit. In the past, this has presented a serious obstacle to the successful prosecution of reorganization plans. In *Northern Pac. Ry. Co. v. Boyd*,⁷³ the principle was established that stockholders may not combine with bondholders in a friendly foreclosure sale to freeze out general creditors and obtain an interest in the new corporation which is derived in whole or in part from their interest in the old, free and clear of the claims of its creditors. The creditor of the old corporation was granted recourse against the reorganized property in the hands of the new.

The facts of the case were these: the reorganizers, representing the bondholders, bought in the road for some \$61,000,000 which was paid almost wholly in bonds and which was less than the amount of the mortgage debts of \$157,000,000. They planned to raise \$11,000,000 in cash for the new company by allowing the stockholders in the old company a chance to buy the new stock by "assessment" of \$10 or \$15 on their old shares, an amount which would make the new shares valuable to these "purchasers." Before the mortgage was foreclosed a suit had been brought by Paton an unsecured creditor alleging that the foreclosure was a conspiracy between the bondholders and the stockholders. The circuit court held against these creditors that, the assets being insufficient to pay the mortgage debt, there was no equity from which the unsecured creditors could be paid and no reason why the bondholders should not make any arrangement they chose with the old stockholders. No appeal was taken in that case. But this was not binding on Boyd. The road was sold for \$61,000,000 and the reorganized corporation at once issued \$190,000,000 in bonds and \$155,000,000 of stock on property which a month before had been bought for \$61,000,000.

Boyd was a creditor of the Northern Pacific Railroad Company. No provision was made for unsecured creditors, such as Boyd, on the assumption that any equity in the assets which they could have reached would be cut off by the foreclosure sale. Boyd bought a creditor's bill against the new railway corporation ten years after the foreclosure sale, seeking to subject the assets acquired by the present Northern Pacific railway to the payment of his judg-

⁷³ 228 U. S. 482, 57 L. Ed. 931, 33 Sup. Ct. 554. See 36 Harvard Law Rev. 1007, Railroad reorganization in the federal courts; the unsecured

creditor; Cravath, Reorganization of corporations, Some legal phases of corporate financing, etc., pp. 153, 191.

ment against the old road. He assailed the validity of the reorganization because it was based on a plan which made no provision for the payment of the unsecured creditors, although the old stockholders retained an interest by receiving new shares partly in consideration of the old. The United States Supreme Court by a divided vote sustained Boyd's claim to follow the property of the old company in the hands of the new on the theory that the property was a trust fund charged primarily with the payment of corporate liabilities.

It was held that the foreclosure sale was not necessarily final in cutting off unsecured creditors where the stockholders share in the reorganized enterprise in consideration of the old stock. A transfer which preserves to a stockholder an interest in the new corporation in consideration of his interest in the old is fraudulent as against creditors unless the reorganization plan gives them a fair offer of securities in the reorganized company superior to the offer made to the old stockholders. Any device by which the creditor is postponed to the stockholder, or the stockholder is preferred to the creditor, is invalid. It was recognized, however, in this and later cases that there is no objection to stockholders joining in the purchase of the property of the old corporation at the foreclosure sale, or in the purchase of securities of the new corporation if unsecured creditors are given an opportunity to participate in the reorganized corporation on fair terms, and the subordinate interest of the stockholders is not preserved at the expense of the creditors. So if the old stockholders pay the full par value of the stock in the new corporation neither they nor the new company would be liable on the principle of the *Boyd* case.⁷⁴

In *Western U. Tel. Co. v. United States & Mexican Trust Co.*,⁷⁵ Sanborn, J., says: "The property of an insolvent railroad corporation in the custody of a court in a suit to foreclose a mortgage upon it is charged with a trust for the benefit, first, of the holders of preferential claims superior in equity to the lien of the mortgage; second, of the holders of the lien of the mortgage and

⁷⁴ *Oehring v. Fox Typewriter Co.*, 272 Fed. 833 (where on reorganization, stockholders of old company receive nothing for their stock, and pay cash for new stock, they are not liable for the debts of the old company on the theory of having received a benefit from their stock in priority to creditors); *Sebree v. Cassville & W. R. Co. (Mo.)*, 212 S. W. 11, 16.

⁷⁵ 221 Fed. 545, 549, citing *Northwestern Pac. Ry. Co. v. Boyd*, 177 Fed. 804, aff'd 228 U. S. 482, 502, 504, 57 L. Ed. 931, 33 Sup. Ct. 554; *Louisville Trust Co. v. Louisville, N. A. & C. R. Co.*, 174 U. S. 674, 683, 684, 43 L. Ed. 1130, 19 Sup. Ct. 827; *Central Improvement Co. v. Cambria Steel Co.*, 210 Fed. 696, 701, 702.

of other such liens in their order of priority; third, of the unsecured or general creditors of the mortgagor; and fourth, of its stockholders. Any plan or scheme threatened or executed whereby the holders of the bonds secured by the mortgage and the stockholders secure, or intend or undertake to secure, to the stockholders, by contract, foreclosure sale, or other device, an equal or a greater benefit from the property than is thereby secured to, or offered to and rejected by, the general creditors, is such a breach or threatened breach of trust as entitles any complaining creditor to relief in a court of equity. A purchase through a foreclosure sale, or otherwise, of the property of an insolvent corporation by a new corporation, pursuant to a plan or scheme of the bondholders and stockholders of the insolvent company, whereby the stockholders thereof derive, by receipt of stock or bonds of the new company, or otherwise, benefits equal to or greater than those received by, or openly offered to and rejected by, its general creditors, is fraudulent in law as to the latter, and renders the new corporation and the property it purchased at such sale liable for the claims of such creditors against the old company, at least to the extent of the value of the interest secured by the stockholders of the old company in excess of the value of the interest secured by, or openly offered to and rejected by, the unsecured creditors.”

In the *Boyd* case, the United States Supreme Court held that if stockholders are given a valuable interest in the new corporation in consideration of their stock, without an opportunity being given to unsecured creditors to participate in the reorganization plan on fair and equitable terms, the property in the hands of the new corporation remains subject to the claims of the unsecured creditors to the extent of the value of the stockholders’ interest.⁷⁶ The decision was based upon the theory that the assets of a corporation constitute a trust fund for the payment of corporate liabilities, and consequently a device which preserves to the stockholder his interest in the corporation is invalid as against excluded creditors of the corporation.

⁷⁶ Followed in *Kansas City Southern Ry. Co. v. Guardian Trust Co.*, 240 U. S. 166, 60 L. Ed. 579, 36 Sup. Ct. 334, approving *Central Improvement Co. v. Cambria Steel Co.*, 210 Fed. 696; *Mountain States Power Co. v. A. L. Jordan Lumber Co.*, 293 Fed. 502; *Howard v. Maxwell Motor Co.*, 269 Fed. 292, 303, aff’d 275 Fed. 53; *Western U. Tel. Co. v. United States*

& Mexican Trust Co., 221 Fed. 545. The *Boyd* case has been followed in state courts. *Wabash Ry. Co. v. Marshall*, 224 Mich. 593, 195 N. W. 134; *Pittsmond Copper Co. v. O’Rourke*, 49 Mont. 281, 292, 303, 141 Pac. 849. See *Sweeney v. Heap O’Brien Min. Co.*, 194 Mo. App. 140, 148, 186 S. W. 739.

Where former stockholders purchase stock in the new corporation, paying full value for the stock, the principle of the *Boyd* case does not apply.⁷⁷ In such case, the stockholder receives nothing by virtue of his stock in the old corporation. For this reason, also, a corporation owning most of the stock of an insolvent corporation, may purchase the bonds of the insolvent, foreclose the mortgage and purchase the property at the foreclosure sale, without rendering itself liable to general creditors of the insolvent corporation.⁷⁸ It is only where stockholders receive an interest in the new corporation for stock held in the old, that adequate provision for unsecured creditors must be made. In such case, it has been stated,⁷⁹ fair or equitable terms in the reorganization plan must be offered to the unsecured creditor. This affords but a vague test of what is required and must necessarily depend upon the facts and circumstances of each case.⁸⁰ The preference of the creditor over the stockholder, it seems, must in some way be recognized. Subsequent decisions indicate to some extent what is required.⁸¹

Probably the most significant result of the *Boyd* case has been the expanding jurisdiction taken by equity courts over corporate reorganizations. Prior to the *Boyd* case, the courts concerned themselves only with the receivership and foreclosure proceedings, taking little notice of the reorganization plan. In the absence of fraud, the foreclosure sale was regarded as settling the rights of the parties in respect to the property, the purchaser taking free

⁷⁷ *Oehring v. Fox Typewriter Co.*, 272 Fed. 833. See also, *Sebree v. Cassville & W. R. Co.* (Mo.), 212 S. W. 11, 16.

⁷⁸ *Male v. Atchison, T. & S. F. R. Co.*, 230 N. Y. 158, 165, 129 N. E. 458, 15 A. L. R. 1098.

⁷⁹ *Northern Pac. Ry. Co. v. Boyd*, 228 U. S. 482, 508, 57 L. Ed. 931, 33 Sup. Ct. 554.

⁸⁰ See *Stetson, Cravath, et al., Some Legal Phases of Corporate Financing, Reorganization, and Regulation*, pp. 153, 196; *Walker, Reorganization by Decree: Recent Noteworthy Instances*, 6 *Cornell Law Quarterly*, 154, 159.

⁸¹ In a Michigan case receivership and foreclosure proceedings were commenced against an insolvent corporation. The bondholders and stockholders through committees thereupon prepared a plan for the organization of

a new corporation to purchase the property on foreclosure. Unsecured creditors were offered in settlement of their claims, 25 per cent in convertible preferred stock B, and 75 per cent in common stock of the new corporation. In an action by the new corporation, organized pursuant to this plan, to restrain a judgment creditor of the old corporation from levying execution on the property of the new corporation, it was held, that since the plan inadequately provided for unsecured creditors, the defendant might enforce his claim by proceeding against the property in the hand of the new corporation. *Wabash Ry. Co. v. Marshall*, 224 Mich. 593, 195 N. W. 134. See also, 8 *Minnesota Law Rev.* 604 (*Corporate reorganizations*); *Safety Car Heating & Lighting Co. v. United States Light & Heating Co.*, 2 Fed. (2d) 384.

from the claims of the old corporation, stockholders, or creditors.⁸² The decision of the *Boyd* case, however, recognizes that foreclosure sale is ordinarily only a step in the reorganization proceedings rather than an adjudication of rights.⁸³ This use of the judicial machinery soon induced the courts to take cognizance of the reorganization plan. In *Guaranty Trust Co. of New York v. Missouri Pac. Ry Co.*,⁸⁴ in answer to the contention that reorganization plans are matters of private concern free from judicial interference, it was said, "many railroad receiverships . . . are but instruments for consummating plans of reorganization and courts have come to realize that such use of their jurisdiction and processes entails a correlative duty to those affected by the result."⁸⁵ Following this case, an injunction prohibiting a meeting to carry out a reorganization plan was sustained on the ground that the plan was unfair.⁸⁶

§ 251. Reorganization by decree without sale.

Phipps v. Chicago, R. I. & P. Ry. Co.,⁸⁷ raised the question of the power of the courts to compel nonassenting creditors to accept

⁸² *Ferguson v. Ann Arbor R. Co.*, 17 N. Y. App. Div. 336, 45 N. Y. Supp. 172, 173; *In re Pennsylvania Transp. Co.'s Appeal*, 101 Pa. St. 576.

⁸³ See *Louisville Trust Co. v. Louisville, N. A. & C. R. Co.*, 174 U. S. 674, 683, 43 L. Ed. 1130, 19 Sup. Ct. 827.

⁸⁴ 238 Fed. 812. A motion to strike from the files an intervening petition of a bondholders' committee attacking the reorganization plan was denied on the ground that the bondholders were improperly provided for in the plan. In *St. Louis-San Francisco Ry. Co. v. McElvain*, 253 Fed. 123, an injunction was granted restraining a creditor from prosecuting an action in a state court against the new corporation after a decree has been entered declaring the plan a fair one.

⁸⁵ *In re Prudential Outfitting Co. of Delaware, Inc.*, 250 Fed. 504, 506.

⁸⁶ *Graselli Chemical Co. v. Aetna Explosives Co.*, 252 Fed. 456. For a discussion of this case, see Rosenberg, *The Aetna Explosives Case—A Milestone in Reorganization*, 20 *Columbia Law Rev.* 733. See also, 8 *Minnesota Law Rev.* 604.

In *Harding v. American Sumatra Tobacco Co.*, 14 Fed. (2d) 168, Sibley,

D. J., says that the doctrine of the *Boyd* Case that the rights of creditors discriminated against might be enforced in equity, notwithstanding the formal judicial sale, "led to the practice of submitting the reorganization plan to the court ordering the sale in advance of its consummation that judicial approval might be had of the terms and that the reorganizers might be secure. To this end all persons at interest are cited by substituted service to appear to make known their objections, if any, on the assumption that thereby they will be concluded by the decision of the court upon the fairness of the plan. This practice was approved, and the fairness of a proposed reorganization by sale passed upon, by the Supreme Court in *Kansas City Terminal Ry. Co. v. Central Union Trust Co. of New York*, 271 U. S. 445, 70 L. Ed. 1028, 46 Sup. Ct. 549. See also the case of *Chicago, R. I. & P. Ry. Co. v. Lincoln Horse & Mule Commission Co.*, 284 Fed. 955."

⁸⁷ 284 Fed. 945, 28 A. L. R. 1184; *Chicago, R. I. & P. Ry. Co. v. Lincoln Horse & Mule Commission Co.*, 284 Fed. 955. Since there were no bondholders involved, these cases deal only with the rights of unsecured creditors.

stock or securities for their claims instead of cash, and thus avoid the expense and waste of a judicial sale. It was held that a court which through its receiver takes possession of an insolvent railroad company, may compel unsecured creditors to submit to a plan of reorganization by which they will receive their fair share of the property or stock. The federal court went to the extent of returning the property to the old corporation without a judicial sale and imposed upon the dissenting minority of the unsecured creditors a plan of reorganization, approved by the court, without a cash alternative to which they would have been entitled had the property been sold. Under this decision, an offer to the unsecured creditor of securities in the new corporation under a plan of reorganization, approved by the court, will bar any recourse against the new corporation although the unsecured creditor was entitled to have the property of the corporation subjected to the payment of his claims. The principle of this case might well be extended to requiring secured creditors to accept securities in the new corporation in payment of their claims. While it may be contended that the secured creditor cannot be deprived of the remedies to which he is entitled under the mortgage,⁸⁸ yet, when it is considered that by the *Phipps* case the unsecured creditor was deprived of his right to have the assets of the corporation applied to the satisfaction of his claims, the difference would seem to be only one of degree.⁸⁹ And the necessity of compelling dissenting creditors to accept adequate provisions made for them in order to carry out corporate reorganizations more successfully, would seem to justify a limitation of the rights of secured creditors as well.

The procedure of foreclosure and judicial sale is that of a complete change of ownership, while the real purpose is simply an arrangement whereby a new financial structure can be established. The old security holders must inevitably be the purchasers under the foreclosure sale. The decree of sale is merely a device or step in the process of readjustment of securities. The former owners buy back the property with such a modified interest in it as it can support by a scaling down of the securities. Tremendous expense is involved in a judicial sale, the incorporation of a new company,

⁸⁸ See note, 28 A. L. R. 1184; Walker, Reorganization by Decree: Recent Noteworthy Instances, 6 Cornell Law Quarterly 154, 165; 27 Columbia Law Rev. 154.

⁸⁹ See Rosenberg (*Phipps v. Chi-*

cago, R. I. & P. Ry. Co., 284 Fed. 945, 28 A. L. R. 1184), 24 Columbia Law Rev. 266, 271; Rosenberg, Reorganization—The Next Step, 22 Columbia Law Rev. 14, 17.

the authorization of the issue of its securities, and the formalities of transfer which can be avoided by a decree having the effect of a sale, which fixes the value of the various claims in new securities. It is a case where the stockholders, general creditors and bondholders must sacrifice something if the property and business are to be saved and this can best be ascertained without the form of a forced sale.⁹⁰ The court under the doctrine of the *Phipps* case, may restrain the creditors from resorting to any other method of collecting their debts than that provided in the plan approved by the court.⁹¹ This is somewhat similar to the power of enforcing reorganization plans under the British Reconstruction Acts, where terms fair and reasonable to the different classes of security holders are embodied in a decree of court.

⁹⁰ In 22 Columbia Law Rev. 14, 23, Rosenberg says: "In the Rock Island case, Judge Carpenter concluded that he could accomplish directly by decree that which he could accomplish indirectly by sale, to wit: the ascertainment of a cash value for the general creditors. He further decided that he had the power to fix that value in new stock. A decree to that effect was entered and no alternative cash provision for creditors was made."

In *Harding v. American Sumatra Tobacco Co.*, 14 Fed. (2d) 168, Sibley, D. J., remarked: "The same court . . . went yet further in *Phipps v. Chicago, R. I. & P. Ry. Co.*, 284 Ed. 945, 28 A. L. R. 1184, and held that a creditor who did assert his claim could not, after approval of the reorganization by the court over his protest, claim payment in money, but must take the securities provided by the reorganization agreement or nothing. There was no judicial sale in the case last cited and no transfer of the assets to another corporation, but a mere adjudication that the creditors and stockholders must take what was provided in the reorganization, or nothing, notwithstanding the reorganization was arranged for while the court was holding them off from asserting their ordinary legal rights. This is a stretching of equity power beyond anything previously known, and quite beyond the intimations in the *Boyd* case (228 U. S.) at page

508 (33 Sup. Ct. 554), repeated in *Kansas City Terminal Ry. Co. v. Central Union Trust Co. of New York*, supra. To deprive a creditor of his usual remedies and force him into membership in the corporation which he only credited seems to me to be of very dubious correctness, however convenient and cheap it may be to reorganizers, and however justly disappointing to recalcitrant minorities, who may be trying to force the majority to buy them out to get rid of them."

Compare 9 Cornell Law Quarterly 192; 5 Cook, Corporations (8th Ed.), p. 4107, sec. 883; 27 Columbia Law Rev. 586; 36 Yale Law Journal 997, Minority interests in reorganization proceedings.

⁹¹ In *re Prudential Outfitting Co., of Delaware, Inc.*, 250 Fed. 504, it is held that a bankruptcy court (as contrasted with a court of equity in a receivership under a creditor's bill or a foreclosure), has no power to compel creditors to accept an aliquot interest in the assets of a bankrupt corporation, under the guise of a sale, as by delivering to creditors preferred stock in a new corporation for the amount of their claims. The new corporation must make a cash bid and the receiver must pay in cash those creditors whose claims the new corporation does not hold by assignment. See 22 Columbia Law Rev. 127.

CHAPTER XX.

DISSOLUTION OF CORPORATIONS; FORFEITURE OF CHARTER.

1. HOW CORPORATIONS MAY BE DISSOLVED.

§ 252. In general.—In the absence of statutory provisions, a corporation may be dissolved, and thus cease to exist, in the following ways only:

- (1) By an act of the legislature repealing or withdrawing its charter, provided the legislature, in granting the charter, has reserved the power of repeal.
- (2) By the expiration of the time limited in its charter for its existence.
- (3) By the happening of some contingency prescribed in its charter or by statute.
- (4) By the failure or loss of members of nonstock corporations but not by the acquisition of all stock by a single holder.
- (5) By a voluntary surrender of its charter by the stockholders, authorized or accepted by the state.
- (6) By judgment of dissolution in a judicial proceeding by the state for misuser, nonuser, breach of conditions subsequent or other ground of forfeiture or dissolution.
- (7) By decree of a court of equity in some states.

A corporation is said to be dissolved when the franchise to be a corporation conferred upon it by the state is extinguished, and its corporate existence terminated. It is said by Blackstone that a corporation may be dissolved in four ways, namely: (1) By act of parliament; (2) by the natural death of all its members, in case of an aggregate corporation; (3) by the surrender of its franchise into the hands of the king, which he calls a kind of suicide; and (4) by forfeiture of its charter through negligence or abuse of its franchises, in which case, he says, the law judges that the body politic has broken the condition upon which it was incorporated, and thereupon the incorporation is void.¹

¹ 1 Bl. Com. 485. And see 2 Kyd, 245; Angell & Ames, Corporations Corporations, 447; 2 Kent's Com. 501; Boston Glass Manufactory v.

This statement, however, is not accurate when applied to modern business corporations in this country. The legislature cannot repeal the charter of a corporation unless the power to do so was reserved when the corporation was created. Nor are modern joint-stock companies dissolved by the death of members, for the shares of stock in such corporations pass, on the death of the holders, to their personal representatives or legatees. Nor, according to the weight of authority, can a corporation be dissolved by the voluntary surrender of its charter, unless the surrender is authorized or accepted by the state. Nor does a corporation cease to exist, *ipso facto*, because of negligence or abuse of its franchises. There must first be a judgment of forfeiture in proceedings by the state. It is more accurate, therefore, to say that a corporation may be dissolved in the following ways: (1) By an act of the legislature repealing or withdrawing its charter, provided the legislature, in granting the charter, has reserved the power to repeal the same, but not otherwise; (2) by the expiration of a time limited in its charter for the continuance of its corporate existence; (3) by the happening of some contingency prescribed in its charter or by statute; (4) by a surrender of its charter, provided the surrender is authorized or accepted by the state; and (5) by the forfeiture of its charter in a judicial proceeding by the state; (6) by decree of court of equity in some states.²

Dissolution versus liquidation.—A corporation dies or terminates its legal existence only when it is dissolved or its charter expires by limitation or by forfeiture. Neither bankruptcy or receivership necessarily results in dissolution. But a company is for all practical purposes dead when it goes out of business, as where it sells all its assets including its good will. Other forms of corporate liquidation are a general assignment for the benefit of creditors, winding up by a court of equity on a bill of a shareholder, or more commonly on a creditor's bill for general administration.^{2a}

§ 253. Jurisdiction of courts of equity.

It was formerly regarded as a general rule that, unless jurisdiction was conferred by statute, courts of equity have no jurisdiction

Langdon, 24 Pick (Mass.) 49, 35 Am. Dec. 292; Penobscot Boom Corporation v. Lamson, 16 Me. 224, 33 Am. Dec. 656; Mechanics' Bank v. Heard, 37 Ga. 401.

² 14A C. J. 1081.

^{2a} Nashville Packet Co. v. Neville, 144 Tenn. 698, 235 S. W. 64.

to decree a dissolution of a corporation, or declare a forfeiture of its charter for misuser or nonuser, or appoint a receiver for a corporation to distribute its assets and wind up its affairs, but the only remedy was at law. And this was true, whether the suit was brought by a stockholder or other private individual,³ or by the attorney or solicitor general in the name and on behalf of the state.⁴

It has, however, been pointed out "that this rule had its origin at a time when corporations were created by special charters, the grants of which conferred valuable and exclusive franchises upon their grantees, and it was considered that, as the franchises were granted by the state, they could be vacated or forfeited only in a proceeding by the state. . . . The reason for this rule has entirely ceased in respect to the ordinary business corporation formed under general laws."⁵ The early doctrine that equity could not interfere because that would result in dissolution is being modified by exceptions to protect the minority stockholders in case of need.^{5a} According to a leading Michigan case, supported also by numerous decisions in other jurisdictions, there may be circumstances under which a court of equity, for want of any adequate remedy at law, will have the power, to afford relief to stockholders against fraud, even to the extent of dissolving the corporation and winding up its affairs. Thus, it was held in the case referred to that a court of equity had jurisdiction, at the suit of a stockholder, to appoint

³ State Inv. & Ins. Co. v. Superior Court, 101 Cal. 135, 35 Pac. 549; Wheeler v. Pullman Iron & Steel Co., 143 Ill. 197, 32 N. E. 420, 17 L. R. A. 818; Coquard v. National Linseed Oil Co., 171 Ill. 480, 49 N. E. 563; Hunt v. Le Grand Roller Skating Rink Co., 143 Ill. 118, 32 N. E. 525; Wallace v. Pierce-Wallace Publishing Co., 101 Iowa, 313, 70 N. W. 216, 38 L. R. A. 122, 63 Am. St. Rep. 389; Mason v. Supreme Court of Equitable League of Baltimore, 77 Md. 483, 27 Atl. 171, 39 Am. St. Rep. 433; Folger v. Columbian Ins. Co., 99 Mass. 267, 274, 96 Am. Dec. 747; Attorney General v. Utica Ins. Co., 2 Johns. Ch. (N. Y.) 371; Waterbury v. Merchants' Union Exp. Co., 50 Barb. (N. Y.) 157; Brock v. Poor, 216 N. Y. 387, 111 N. E. 229; Lyon v. McKeefrey, 171 Fed. 384, 394 (Pennsylvania law); Maguire v. Mortgage Co. of America, 203 Fed. 858; Ashton v. Penfield, 233 Mo. 391, 135 S. W. 938;

Enterprise Prtg. & Pub. Co. v. Craig, 195 Ind. 302, 144 N. E. 542, 145 N. E. 309; Furrer v. Nebraska Bldg. & Inv. Co., 108 Neb. 698, 189 N. W. 359, 43 A. L. R. 225, 289.

⁴ Attorney General v. Tudor Ice Co., 104 Mass. 239, 6 Am. Rep. 227; Attorney General v. Stevens, 1 N. J. Eq. 369, 22 Am. Dec. 526; Attorney General v. Utica Ins. Co., 2 Johns. Ch. (N. Y.) 371; People v. Equity Gas Light Co., 141 N. Y. 232, 36 N. E. 194; People v. Weigley, 155 Ill. 491, 40 N. E. 300; People v. Equity Gas Light Co., 141 N. Y. 232, 36 N. E. 194.

⁵ Goodwin v. Von Cotzhausen, 171 Wis. 351, 177 N. W. 618; Gibbs v. Morgan, 9 Idaho 100, 72 Pac. 733.

^{5a} See Fletcher, Corporations, secs. 5530, 5546-5551. As where there are hopeless dissensions; where the purpose of the corporation becomes impossible of attainment, and in cases of fraud and mismanagement.

a receiver and wind up the affairs of a corporation, where a majority of the stockholders had for a long time fraudulently excluded the complaining stockholder from participation in the management and profits of the corporation, and managed it in their own interest and for their own profit only.⁶

As the Wisconsin court says:⁷ “* * * There is now a respectable array of judicial authority to the proposition that where a corporation has been plundered by its officers, or they have so mismanaged its affairs as to bring it to the verge of bankruptcy, threatening the minority stockholders with loss of their investment, and it seems certain that the purposes for which the corporation was organized are no longer attainable, and there is no other adequate remedy, a court of equity, in the exercise of its inherent power, will appoint a receiver for the corporation, wind up its affairs, distribute its assets, and decree a dissolution thereof at the suit of a minority stockholder.”

In a Minnesota case,⁸ M was president and a director of a corporation. He refused to recognize plaintiff as secretary and also refused to recognize any of the minority stockholders as having

⁶ *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, 53 N. W. 218, 17 L. R. A. 412; *Red Bud Realty Co. v. South*, 96 Ark. 281, 131 S. W. 340; *Gibbs v. Morgan*, 9 Idaho 100, 72 Pac. 733; *Riley v. Callahan Min. Co.*, 28 Idaho 525, 155 Pac. 665; *Thwing v. McDonald*, 134 Minn. 148, 156 N. W. 780, 158 N. W. 820, 159 N. W. 564, Ann. Cas. 1918E 420; *Phinizy v. Aniston City Land Co.*, 195 Ala. 656, 71 So. 469; *Brent v. Brister Sawmill Co.*, 103 Miss. 876, 60 So. 1018, 43 L. R. A. (N. S.) 720, Ann. Cas. 1915B 576; *Exchange Bank of Wewoka v. Bailey*, 29 Okla. 246, 116 Pac. 812, 39 L. R. A. (N. S.) 1032; *Metropolitan Fire Ins. Co. v. Middendorf*, 171 Ky. 771, 188 S. W. 790.

⁷ *Goodwin v. Von Cotzhausen*, 171 Wis. 351, 177 N. W. 618. Other authorities to the same effect in principle are: *Exchange Bank of Wewoka v. Bailey*, 29 Okla. 246, 116 Pac. 812, 39 L. R. A. (N. S.) 1032 note; *Brent v. B. E. Brister Sawmill Co.*, 103 Miss. 876, 60 So. 1018, 43 L. R. A. (N. S.) 720, Ann. Cas. 1915B 576; *Gibbs v. Morgan*, 9 Idaho 100, 72 Pac. 733; *Ponca Mill Co. v. Mikesell*, 55 Neb. 98, 75 N. W. 46; *Klugh v. Coronaca Milling Co.*, 66 S. C. 100, 44 S. E. 566; *Null v. Parsons*, 145 Ill. App.

436; *Thwing v. McDonald*, 134 Minn. 148, 156 N. W. 780, 158 N. W. 820, 159 N. W. 564, Ann. Cas. 1918E 420; *Green v. National Advertising & Amusement Co.*, 137 Minn. 65, 70, 162 N. W. 1056, L. R. A. 1917E 784; *Boothe v. Summit Coal Min. Co.*, 55 Wash. 167, 104 Pac. 207, 19 Ann. Cas. 1255; 8 *Fletcher's Cyc. Corporations* 5548; 7 *R. C. L.* 740, note 4.

⁸ *Thwing v. McDonald*, 134 Minn. 148, 156 N. W. 780, 158 N. W. 820, 159 N. W. 564, Ann. Cas. 1918E 420, 424n; *Schipper Bros. Coal Min. Co. v. Economy Domestic Coal Co.*, 277 Pa. 356, 121 Atl. 193 (court may appoint receiver to conduct affairs of corporation and may direct a sale of the property and distribution of the proceeds if the difficulties and disagreements of its two equal stockholders cannot be eliminated); *In re New Jersey Refrigerating Co.*, 95 N. J. Eq. 215, 122 Atl. 832; *Nelson v. United Elevators Co.*, 115 Kan. 567, 223 Pac. 814; *Bowen v. Bowen-Romer Flour Mills Corporation*, 114 Kan. 95, 217 Pac. 301, 43 A. L. R. 238, 242n. Inherent power of equity, at instance of a stockholder, to appoint a receiver for, or to wind up, a solvent going corporation, on the ground of fraud, mismanagement or dissensions.

any interest in the corporation or its assets and assumed exclusive control of the company. The court removed M from his position as officer and director, appointed receivers to take charge and manage the affairs of the corporation, directed M to account for the funds and effects of the corporation, dissolved the corporation and provided for winding up its affairs and distributing its property to its stockholders. It was held that when minority stockholders are being deprived of their property by the unlawful acts of the majority, a court of equity will intervene and afford such relief as may be necessary. But dissolution will not be decreed if there is any other adequate form of relief.

In a Tennessee case,⁹ plaintiff, owner of one-half the stock in the N. P. Company, brought suit in the name of the corporation against the defendant, the owner of the other half of the stock, for dissolution of the corporation, although it was solvent. Plaintiff charged the defendant with misconduct in connection with the corporate business, and alleged that relations between them had become so hostile that it was impossible for them to carry on the business. The defendant opposed winding up the corporation. It was held that equity will intervene and appoint a receiver to wind up the corporation, though solvent, where there is such friction that the corporation cannot be successfully continued.

Whether a court of equity may appoint a receiver in a stockholder's suit, not for the purpose of dissolving the corporation, but merely for the purpose of preserving the assets of the corporation, and preventing irreparable loss or injury pending the suit, is a very different question; and it is well settled that such power exists, as it does in the case of a partnership, if the circumstances render its exercise necessary. If it were otherwise, a stockholder would often be practically without any adequate remedy at all. Under statutes in some states, and independently of any statutes in others, the court may appoint a receiver in a stockholder's suit if the directors and majority of the stockholders are so managing or disposing of its business or assets in their own interest that they will probably be lost or destroyed before a decree can be rendered, or where there are such dissensions within the corporation that its

⁹ Nashville Packet Co. v. Neville, 114 Tenn. 698, 235 S. W. 64 noted, 6 Minn. Law Rev. 409. See Bowen v. Bowen-Romer Flour Mills Corporation, 114 Kan. 95, 99, 217 Pac. 301, 43 A. L. R. 238 (dissensions created

a deadlock so that the proper operation of the corporation was impossible); Nelson v. United Elevators Co., 115 Kan. 567, 223 Pac. 814; 4 Pomeroy, Equity Jurisp. (4th Ed.), sec. 1537.

business cannot be honestly or properly managed, or if for any other reason it clearly appears to the court that the appointment of a receiver pending the suit is necessary to preserve the assets of the corporation, and protect the rights of the complaining stockholders.¹⁰ Without such a showing as this, however, a court will not appoint a receiver at the suit of a minority stockholder, and thus take the management of the corporation out of the hands of its directors and stockholders, even for a limited time, although the latter may be charged with fraud and mismanagement.^{10a}

There are express statutory provisions in some states under which a stockholder may sue for the appointment of a receiver and a winding up or dissolution of the corporation under circumstances specified in the statute.¹¹

§ 254. Dissolution of corporation by act of the legislature repealing charter.

If the state, in granting a charter, has reserved the right to repeal the same, either by a provision to that effect in the charter itself, or by a constitutional provision or general law in force at

¹⁰ Featherstone v. Cooke, L. R. 16 Eq. 298; Sternberg v. Wolff, 56 N. J. Eq. 389, 39 Atl. 397, 39 L. R. A. 762, 67 Am. St. Rep. 494; Wallace v. Pierce-Wallace Pub. Co., 101 Iowa 313, 70 N. W. 216, 38 L. R. A. 122, 63 Am. St. Rep. 389; Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N. W. 218, 17 L. E. A. 412; Becker v. Gulf City Street Railway & Real Estate Co., 80 Tex. 475, 15 S. W. 1094.

In *Riverside Oil & Refining Co. v. Lynch*, 114 Okla. 198, 243 Pac. 967, the Oklahoma court upheld the appointment of a receiver in a stockholder's suit against officers. The appointment of a receiver is not necessarily a proceeding to dissolve a corporation; nor will it necessarily result in its extinction.

^{10a} *Waterbury v. Merchants' Union Exp. Co.*, 50 Barb. (N. Y.) 157; *Wallace v. Pierce-Wallace Pub. Co.*, 101 Iowa 313, 70 N. W. 216, 38 L. R. A. 122, 63 Am. St. Rep. 389; *Downing v. Dunlap Coal, Iron & Railway Co.*, 93 Tenn. 221, 24 S. W. 122; *Einstein v. Rosenfeld*, 38 N. J. Eq. 309; *Rumney v. Detroit & M. Cattle Co.*, 116 Mich. 640, 74 N. W. 1043; *Empire Hotel Co. v. Main*, 98 Ga. 176, 25 S. E. 413; *Crombie v. Order of Solon*, 157 Pa. St. 588, 27 Atl. 710.

In *Furrer v. Nebraska Bldg. & Inv. Co.*, 108 Neb. 698, 189 N. W. 359, 43 A. L. R. 225, it is said: "Receiver-ship is the most drastic remedy and the most expensive luxury known to the realm of law."

¹¹ *Wheeler v. Pullman Iron & Steel Co.*, 143 Ill. 197, 32 N. E. 420, 17 L. R. A. 818; *Kieley v. Barron & Cooke Heating & Power Co.*, 87 N. Y. App. Div. 317, 84 N. Y. Supp. 306; *Kelly v. Fargo Mercantile Co.*, 16 S. D. 73, 91 N. W. 350.

In *United States Fidelity & Guaranty Co. v. Vicars*, 10 Fed. (2d) 474, 476, it is said: "The statutes of the territory of Hawaii so referred to are not substantially different from the federal statute providing for the appointment of receivers of national banks. As to that statute the Supreme Court has held that the appointment of a receiver by the Comptroller to wind up the affairs of a national bank does not work a dissolution of the corporation or affect suits pending against it, or prevent it suing or being sued. *Bethel First Nat. Bank v. Pahquioque Bank*, 14 Wall. (U. S.) 383, 20 L. Ed. 840. The court there said: 'Beyond doubt the appointment of a receiver supersedes the power of the directors to exercise the incidental

the time of the grant, the reservation enters into the contract between the state and the corporation. If the power to repeal the charter at the will or pleasure of the legislature is reserved, the power to repeal is absolute, and may be exercised at any time, and without any cause of forfeiture, provided vested rights are not impaired.¹²

§ 255. Dissolution of corporation by expiration of time limited in its charter.

A corporation has the capacity of "perpetual succession," and there have been many instances in which corporations have been created to exist forever.¹³ The legislature may, and generally does, limit their existence to a certain number of years.¹⁴ It is difficult, however, to perceive any particular policy or protection either to the public or to the corporation in placing an arbitrary limit such as 20 or 30 or 50 years upon the corporate life, as there will be trouble and expense in renewing or extending the charter, and serious liabilities may be incurred by the stockholders if business is continued without renewal, as may easily happen through inadvertence. When the time during which a corporation is to exist is thus limited by its charter, it is dissolved and ceases to exist upon the expiration of the time limited, and its existence as a corporation cannot be continued after that time, except by legislative authority, even with the consent of all the stockholders or members.¹⁵ According to some authorities, as was shown in a

powers necessary to carry on the business of banking, as the receiver is required to take possession of the books, records and assets of every description of the association; . . . but the corporate franchise of the association is not dissolved, and the association, as a legal entity continues to exist.' "

¹² *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32; *Greenwood v. Union Freight R. Co.*, 105 U. S. 13, 26 L. Ed. 961; *Read v. Frankfurt Bank*, 23 Me. 318. See post, § 278.

¹³ When a corporation is created by a special act without any limitation as to the duration of existence, its charter gives it the capacity of perpetual existence. *Snell v. City of Chicago*, 133 Ill. 413, 24 N. E. 532, 8 L. R. A. 858; *State ex rel. Clover v. Ladies of the Sacred Heart*, 99 Mo. 533, 12 S. W. 293, 6 L. R. A. 84.

¹⁴ The use of the words "perpetual succession" in the charter of a corporation does not necessarily mean that it shall continue forever, but may mean merely that it shall have continuous existence during a particular period, and should be so construed when such an intention on the part of the legislature appears. *State ex rel. Walker v. Payne*, 129 Mo. 468, 31 S. W. 797, 33 L. R. A. 576; *Morawetz, Corporations*, sec. 411. "Perpetual succession" refers to the continuous existence which enables a corporation to hold property without the necessity of conveyances; title remains in the legal entity although the members may continually change; it means unbroken continuity of existence.

¹⁵ *Mason v. Pewabic Min. Co.*, 25 Fed. 882; *Commercial Bank v. Lockwood's Adm'r*, 2 Har. (Del.) 8; *Brad-*

former chapter, there may not be found even a *de facto* corporate existence after expiration of its charter.¹⁶

Sometimes, by express statutory enactment, the existence of corporation created for a limited time is extended for a certain time beyond the period limited, for the purpose of winding up their affairs, and of allowing suits by and against them. Such a statute, as we have seen, may be constitutionally enacted after a corporation is created for a limited time, for it does not impair any rights of the corporation, or of its creditors or stockholders, but merely provides for the enforcement of rights and liabilities which, in the absence of a statute, would be recognized and enforced in equity.¹⁷

§ 256. Dissolution of corporation by the happening of a contingency prescribed by its charter.

A corporation may also be dissolved by the happening of some contingency prescribed in its charter, without any further act upon the part of the legislature, and without any judicial proceedings to declare a forfeiture. If the legislature *clearly* provides in the charter of a corporation that it shall cease to exist on the happening of a certain contingency, the happening of such contingency *ipso facto* terminates the charter and dissolves the corporation. No act of the legislature or judgment of a court declaring a forfeiture is necessary.¹⁸

As we shall see in a subsequent section, however, while it is within the power of the legislature to provide that the existence of a corporation shall cease, without any judicial proceedings and judgment of forfeiture, upon its failure to comply with certain conditions, such an intention should not be implied from language which will reasonably admit of a different construction. "It requires

ley v. Reppell, 133 Mo. 545, 32 S. W. 645, 34 S. W. 841, 54 Am. St. Rep. 685; Sturges v. Vanderbilt, 73 N. Y. 384; Bonfils v. Hayes, 70 Colo. 336, 201 Pac. 677.

¹⁶ Bonfils v. Hayes, 70 Colo. 336, 201 Pac. 677; Bradley v. Reppell, 133 Mo. 545, 32 S. W. 645, 34 S. W. 841, 54 Am. St. Rep. 685; ante, § 24. But see contra, Miller v. Newburg Orrel Coal Co., 31 W. Va. 836, 8 S. E. 600, 13 Am. St. Rep. 903; Bushnell v. Consolidated Ice Mach. Co., 138 Ill. 67, 27 N. E. 596; Wilson v. Brown, 107 N. Y. Misc. 167, 175 N. Y. Supp.

688; Held v. Crosthwaite, 260 Fed. 613, 627. See 47 A. L. R. 1394n.; ante, § 24.

¹⁷ Foster v. Essex Bank, 16 Mass. 245, 8 Am. Dec. 135.

¹⁸ Oakland R. Co. v. Oakland, B. & F. V. R. Co., 45 Cal. 365, 13 Am. Rep. 181; Brooklyn Steam Transit Co. v. City of Brooklyn, 78 N. Y. 524; In re Brooklyn, W. & N. R. Co., 75 N. Y. 335; s. c., 81 N. Y. 69; People ex rel. Hunt v. National Sav. Bank, 129 Ill. 618, 22 N. E. 288; Four-S-Razor Co. v. Guymon, 110 Kan. 745, 205 Pac. 635.

strong and unmistakable language, to authorize the court to hold that it was the intention of the legislature to dispense with judicial proceedings on the intervention of the attorney general.”¹⁹ Provisions for forfeiture are inserted for the benefit and protection of the public, and as in the case of similar provisions in deeds and contracts, it is for the interested party to declare that he elects to avail himself of the forfeiture. Until a judicial decree it is better that the corporation continue its existence.

§ 257. Dissolution of corporation by failure or loss of an integral part.

Another way in which it is said that a corporation may be dissolved, is by the failure or loss of some integral part of its organization which is necessary to enable it to exercise corporate powers, and which cannot be supplied. “Whenever a corporation is reduced to such a state as to be incapable of acting or continuing itself it is dissolved.”²⁰ Thus, a nonstock corporation, is dissolved by the death or withdrawal of all its members, or of such a number of its members that too few remain, under the constitution of the corporation, to continue the succession, and fill vacancies.²¹ But the death or withdrawal of members does not dissolve a corporation, so long as a sufficient number remain to continue the succession and fill up vacancies.²²

Modern stock corporations cannot be dissolved by the death of members, for, on the death of a stockholder, his shares, being property, will pass to his personal representatives or legatee, who will thereupon take his place as a stockholder and member.²³ And a corporation is not dissolved by the death, ineligibility, or withdrawal of its officers, or by a failure to elect officers, for however long a time, so long as there are members of the corporation with powers to elect officers.²⁴

¹⁹ *New York & Long Island Bridge Co. v. Smith*, 148 N. Y. 540, 42 N. E. 1088. And see post, § 260; *Knotts v. Clark Const. Co.*, 191 Ind. 354, 131 N. E. 921, 132 N. E. 678.

²⁰ *Buller, J.*, in *Rex v. Pasmore*, 3 Term R. 245. And see *Penobscot Boom Corporation v. Lamson*, 16 Me. 224, 33 Am. Dec. 656.

²¹ 1 *Rolle's Abr.* 514 (1); *Blackwell v. State*, 36 Ark. 178; *Philips v. Wickham*, 1 Paige (N. Y.) 590.

²² *Blackwell v. State*, 36 Ark. 178; *McGinty v. Athol Reservoir Co.*, 155

Mass. 183, 29 N. E. 510; *Tomlinson v. Bricklayers' Union No. 1*, 87 Ind. 308. See *Clearwater Citrus Growers' Ass'n v. Andrews*, 81 Fla. 299, 87 So. 903.

²³ *Boston Glass Manufactory v. Langdon*, 24 Pick. (Mass.) 49, 35 Am. Dec. 292.

²⁴ *Boston Glass Manufactory v. Langdon*, 24 Pick. (Mass.) 49, 35 Am. Dec. 292; *Higgins v. Downward*, 8 *Houst. (Del.)* 227, 14 *Atl.* 720, 32 *Atl.* 133, 40 *Am. St. Rep.* 141; *Evarts v. Killingworth Mfg. Co.*, 20 Conn.

Nor is a corporation dissolved by the fact that all the shares of its capital stock have come into the hands of a single stockholder, or of a less number of stockholders than were required by the statute in the formation of the corporation.²⁵ The owner of the stock may still carry on business in the corporate name, and the corporate property will be liable for debts of the corporation. Under such circumstances, according to some cases, however, corporate existence and action are suspended until the stock is again distributed among sufficient owners to enable its powers and corporate activity to be revived by a proper organization and election of officers.²⁶

§ 258. Suspension of business; alienation or loss of property; insolvency, etc.

A corporation is not dissolved by the mere failure to exercise the powers conferred upon it by its charter, or by its abandonment of the corporate enterprise after having commenced the exercise of the powers conferred upon it. Such nonuser is ground for a proceeding by the state to forfeit its charter, and, if it has continued for a long time, may raise a presumption of a surrender

447; *Philips v. Wickham*, 1 Paige (N. Y.) 590; *Packard v. Old Colony R. Co.*, 168 Mass. 92, 46 N. E. 433; *Jones Min. Co. v. Cardiff Min. & Mill. Co.*, 56 Utah 449, 191 Pac. 426.

²⁵ *In re Belton*, 47 La. Ann. 1614, 18 So. 642, 30 L. R. A. 648; *Mioton v. Del Corral*, 132 La. 730, 61 So. 771; *Swift v. Smith*, 65 Md. 428, 5 Atl. 534, 57 Am. Rep. 336; *Parker v. Bethel Hotel Co.*, 96 Tenn. 252, 34 S. W. 209, 31 L. R. A. 706; *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 21 S. W. 531, 1049, 19 L. R. A. 684, 42 Am. St. Rep. 353; *First Nat. Bank of Gadsden v. Winchester*, 119 Ala. 168, 24 So. 351, 72 Am. St. Rep. 904; *Newton Mfg. Co. v. White*, 42 Ga. 148; *Voll v. Zelch*, 198 Iowa 1333, 201 N. W. 33.

²⁶ *Templeman v. Grant*, 75 Colo. 519, 227 Pac. 555, 561; *Lang v. Lundy*, 185 Mich. 390, 152 N. W. 78; *Swift v. Smith*, 65 Md. 428, 5 Atl. 534, 57 Am. Rep. 336; *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 21 S. W. 531, 1049, 19 L. R. A. 684, 42 Am. St. Rep. 353; *Louisville & N. R. Co. v. Nield*, 186 Ky. 38, 216 S. W. 62; *First Nat. Bank of Gads-*

den v. Winchester, 119 Ala. 168, 24 So. 351, 72 Am. St. Rep. 904 (semble).

In *Lang v. Lundy*, 185 Mich. 390, 152 N. W. 78, it was held that an assignment of all the corporate assets to the sole stockholder was invalid against a judgment creditor. There is a dictum that if the sole stockholder continued to transact business of the dormant corporation (the powers of which were suspended until the stock was again distributed in good faith among sufficient owners and the election of officers to manage its business), he could not by doing business in its name bind it or impose upon it any indebtedness.

If owner of all the stock converts the entire assets of the corporation to his own use and permits it to lie dormant, direct proceedings may be had against the sole stockholder who has unlawfully absorbed the assets, leaving its creditors in the lurch. A judgment against the corporation would be a mere formality. *Segal v. Davis*, 166 Minn. 265, 207 N. W. 620. See *Angle v. Chicago, St. P., M. & O. Ry. Co.*, 151 U. S. 1, 38 L. Ed. 55, 14 Sup. Ct. 240.

of the charter and acceptance of the surrender by the state;²⁷ but it does not *ipso facto* cause a dissolution.²⁸ A corporation is not even dissolved by an injunction restraining it from the exercise of its corporate franchises, and depriving it of its property.²⁹ Nor is a corporation dissolved, *ipso facto*, by a mere failure to hold meetings, though the neglect has continued for a number of years;³⁰ or by a failure to elect directors or other officers;³¹ or by the fact that conditions have arisen which render it unable to continue the business for which it was created;³² or by the fact that it has not only ceased to exercise the powers conferred upon it by its charter, but has also disposed of all its property by absolute sale, or distributed it among its stockholders, or assigned it for the benefit of creditors, or leased it for a long term of years, or lost it, for a corporation may exist without property.³³ It follows that a corporation is not dissolved by the mere fact that it is insolvent, and unable to pay its debts,³⁴ unless it is expressly so

²⁷ State v. Trustees of Vincennes University, 5 Ind. 77, 87; Combes v. Keyes, 89 Wis. 297, 62 N. W. 89, 27 L. R. A. 369, 46 Am. St. Rep. 839.

²⁸ Boston Glass Manufactory v. Langdon, 24 Pick. (Mass.) 49, 35 Am. Dec. 292; Parker v. Bethel Hotel Co., 96 Tenn. 252, 34 S. W. 209, 31 L. R. A. 706; Attorney General v. Superior & St. C. R. Co., 93 Wis. 604, 67 N. W. 1138; Sleeper v. Goodwin, 67 Wis. 577, 31 N. W. 335; Lincoln v. Kuskokwim Fishing & Transportation Co., 118 Wash. 137, 203 Pac. 62.

Cessation or abandonment of its business by a corporation may amount to a dissolution in such a sense and to such an extent as to render applicable a statute imposing individual liability upon stockholders for the debts of the corporation, and allowing creditors to sue them. Slee v. Bloom, 5 Johns. Ch. (N. Y.) 366, rev'd 19 Johns. (N. Y.) 456; State Sav. Ass'n v. Kellogg, 52 Mo. 583; ante, § 221; Jones v. Edson, 10 Kan. App. 110, 62 Pac. 249. But the suspension of business does not dissolve the corporation further than to allow enforcement of the stockholders' liability. It is not dissolved for all purposes. Jones v. Edson, 10 Kan. App. 110, 62 Pac. 249; Sleeper v. Norris, 59 Kan. 555, 53 Pac. 757. See 11 Cornell Law Quarterly 367.

²⁹ Kincaid v. Dwinelle, 59 N. Y. 548.

³⁰ State v. Trustees of Vincennes

University, 5 Ind. 77, 87; Packard v. Old Colony R. Co., 168 Mass. 92, 46 N. E. 433; Parsons v. Eureka Powder Works, 48 N. H. 66.

³¹ Higgins v. Downward, 8 Houst. (Del.) 227, 14 Atl. 720, 32 Atl. 133, 40 Am. St. Rep. 141; Rose v. Roseburg & M. Turnpike Co., 3 Watts (Pa.) 46; Evarts v. Killingworth Mfg. Co., 20 Conn. 447; Trustees of Vernon Society v. Hills, 6 Cow. (N. Y.) 23, 16 Am. Dec. 429; Jones Min. Co. v. Cardiff Min. & Mill. Co., 56 Utah 449, 191 Pac. 426.

³² See Sleeper v. Goodwin, 67 Wis. 577, 31 N. W. 335; Commonwealth v. Reliance Fire Co., 31 Leg. Int. (Pa.) 46.

³³ Evarts v. Killingworth Mfg. Co., 20 Conn. 447; Higgins v. Downward, 8 Houst. (Del.) 227, 14 Atl. 720, 32 Atl. 133, 40 Am. St. Rep. 141; Boston Glass Manufactory v. Langdon, 24 Pick. (Mass.) 49, 35 Am. Dec. 292; In re Belton, 47 La. Ann. 1614, 18 So. 642, 30 L. R. A. 648. See also, Brock v. Poor, 216 N. Y. 387, 401-410, 111 N. E. 229.

³⁴ Second Nat. Bank of Paterson v. New York Silk Mfg. Co., 11 Fed. 532; Boston Glass Manufactory v. Langdon, 24 Pick. (Mass.) 49, 35 Am. Dec. 292; In re De Camp Glass Casket Co., 272 Fed. 558.

Insolvency may constitute a "dissolution," within the meaning of statutes imposing individual liability upon

provided by some statute;³⁵ or by statutory proceedings in bankruptcy or insolvency, whether voluntary or involuntary;³⁶ or by the appointment of a receiver by a court of equity;³⁷ or by an assignment for the benefit of creditors.³⁸ Under some statutes when franchise or license taxes are not paid, the corporate charter may be forfeited or its powers and privileges may simply be suspended, with provision for revival upon payment.³⁹

§ 259. Voluntary dissolution.

In England a corporation created by the king could be dissolved by the surrender of its charter and acceptance of the surrender by the king; and a corporation created by parliament could be dissolved by such a surrender and its acceptance by parliament. In this country a corporation may be dissolved by the surrender of its charter to the state by vote of the members, and acceptance of its surrender by the state, or by such a surrender under authority of a statute previously enacted, which is equivalent to an acceptance by the state.⁴⁰

stockholders for corporate debts. See *Slee v. Bloom*, 5 Johns. Ch. (N. Y.) 366, rev'd 19 Johns. (N. Y.) 456; *Granger & Co. v. Allen*, 214 N. Y. App. Div. 367, 212 N. Y. Supp. 356, noted in 11 Cornell Law Quarterly 367.

³⁵ *Sprague-Brimmer Mfg. Co. v. M. J. Murphy Furnishing Goods Co.*, 26 Fed. 572.

Where a statute provided that a corporation remaining insolvent for one year should be adjudged to be dissolved, it was held that insolvency for a year did not *ipso facto* dissolve a corporation, but there must be judicial proceedings, and a judgment of forfeiture. *Stolze v. Manitowoc Terminal Co.*, 100 Wis. 208, 75 N. W. 987.

³⁶ *Chamberlin v. Huguenot Mfg. Co.*, 118 Mass. 532; *Coburn v. Boston Papier Mache Co.*, 10 Gray (Mass.) 243; *Exchange Bank of Columbia v. Tiddy*, 67 N. C. 169.

³⁷ On effect of receivership, see *Taylor v. Columbian Ins. Co.*, 14 Allen (Mass.) 353; *State v. Butler*, 86 Tenn. 614, 8 S. W. 586; *Jackson v. McInnis*, 33 Ore. 529, 55 Pac. 535, 43 L. R. A. 128, 72 Am. St. Rep. 755; *Stolze v. Manitowoc Terminal Co.*, 100 Wis. 208, 75 N. W. 987; *Standard Roller Bearing Co. v. Hess-Bright Mfg. Co.*, 275 Fed. 916; *In re Beaver*

Cotton Mills, 275 Fed. 498; *Union Petroleum Co. v. Indian Petroleum Co.*, 192 Iowa 1373, 186 N. W. 439. But the practical effect is sometimes the same as dissolution. *Union Sav. & Inv. Co. v. District Court of Salt Lake County*, 44 Utah 397, 140 Pac. 221, Ann. Cas. 1917A 821; *State ex rel. Hadley v. People's United States Bank*, 197 Mo. 574, 94 S. W. 953. And see note in 8 Am. Law Rep. 453; ante, § 253.

³⁸ *Boston Glass Manufactory v. Langdon*, 24 Pick. (Mass.) 49, 35 Am. Dec. 292; *Weigand v. Alliance Supply Co.*, 44 W. Va. 133, 28 S. E. 803.

³⁹ *Ransome-Crummey Co. v. Superior Court in and for Santa Clara County*, 188 Cal. 393, 205 Pac. 446; *Kaiser Land & Fruit Co. v. Curry*, 155 Cal. 638, 103 Pac. 341; *State ex rel. New Arlington Hotel Co. v. Hinkle*, 115 Wash. 298, 197 Pac. 4; *Held v. Crosthwaite*, 260 Fed. 613.

⁴⁰ *Greeley v. Smith*, 3 Story 657, Fed. Cas. No. 5748; *Crossman v. Vivenda Water Co.*, 150 Cal. 575, 89 Pac. 335; *Mechanics' Bank v. Heard*, 37 Ga. 401; *White v. Davis*, 134 Ga. 274, 67 S. E. 716; *Revere v. Boston Copper Co.*, 15 Pick. (Mass.) 351; *Houston v. Jefferson College*, 63 Pa. St. 428, aff'd 13 Wall. (U. S.) 190, 20 L. Ed.

The error in assuming or holding in some of the cases that a corporation may be voluntarily dissolved without authority from the state has resulted to a great extent, no doubt, from failure to distinguish the dissolution of a corporation from the mere disposal of its property and cessation of business. In the law, they are very different, and to say that a corporation may dispose of all its property and cease to do business does not at all imply that it may dissolve, and thereby cease to exist. As we have seen in another chapter, a purely private corporation, owing no special duties to the public, may dispose of all its property, divide the proceeds among its stockholders, and cease to do the business for which it was organized, if its creditors are not prejudiced thereby. This, however, does not *dissolve* the corporation in contemplation of the law, for it is well settled that it may exist without property and without doing business.⁴¹

There are *dicta* in many of the cases to the effect that the stockholders of a purely private corporation, owing no special duties to the public, may voluntarily surrender their charter and dissolve, without the consent of, or acceptance of the surrender by, the state, provided they act in good faith and without prejudice to creditors; and there are some actual decisions to this effect.⁴² According to the weight of authority, however, a corporation, while it may dispose of its property and cease to do business under some circumstances, cannot be *legally dissolved* by a resolution of the stockholders or members, and a surrender of its charter, unless the surrender is authorized by some statute, or is afterwards accepted or ratified by the state.⁴³ It could still sue and be sued, if the

550; Combes v. Keyes, 89 Wis. 297, 62 N. W. 89, 27 L. R. A. 369, 46 Am. St. Rep. 839. See 40 Harvard Law Rev. 994, Right of holders of nonvoting stock to vote on question of dissolution.

A resolution by the stockholders of a corporation to discontinue its business, under a statute authorizing such a resolution, is a voluntary surrender of the corporate franchise, and a dissolution of the corporation. Law v. Rich, 47 W. Va. 634, 35 S. E. 858. See Warren, 30 Harvard Law Rev. 339, 340.

⁴¹ Ante, § 59. See Warren, 30 Harvard Law Rev. 353; Beidenkopf v. Des Moines Life Ins. Co., 160 Iowa 629, 142 N. W. 434, 46 L. R. A. (N. S.) 290.

⁴² People v. Trustees of College of California, 38 Cal. 166; Merchants' & Planters' Line v. Wagner, 71 Ala. 581; Moore v. Whitecomb, 48 Mo. 543; Van Pelt v. Home Building & Loan Ass'n, 87 Ga. 370, 13 S. E. 574; Lau-man v. Lebanon Val. R. Co., 30 Pa. St. 42, 72 Am. Dec. 685.

⁴³ Boston Glass Manufactory v. Langdon, 24 Pick. (Mass.) 49, 35 Am. Dec. 292. See also, Mechanics' Bank v. Heard, 37 Ga. 401; Mumma v. Potomac Co., 8 Pet. (U. S.) 281, 8 L. Ed. 945; Elvarts v. Killingworth Mfg. Co., 20 Conn. 447; Riddle v. Proprietors of Locks and Canals on Merrimack River, 7 Mass. 169, 5 Am. Dec. 35; Beyer v. Woolpert, 99 Minn. 475, 109 N. W. 1116; Seitz v. Michel, 148 Minn. 80, 181 N. W. 102, 12

occasion for suit should arise.⁴⁴ And, in the absence of dissolution proceedings, there is no principle of law which would prevent it from again acquiring property and resuming business.

Nonuser of its franchise by a corporation, if it is continued for a long time, will raise a presumption that there has been a surrender of its charter, and that it has been authorized or accepted by the state.⁴⁵

The question of the power of the majority of stockholders in the absence of statute to dissolve a corporation is closely allied to the power of the majority to sell all the property of the corporation and retire from active business, against the wishes of the minority. There is authority that the majority cannot do this when the corporation is a prosperous and going concern.⁴⁶ But it has been strongly argued that at common law the majority of the members have power to consent to a dissolution, and that such consent will bind the corporation against the protest of a minority.⁴⁷ The matter is now usually regulated by statutes which often make two-thirds necessary to a dissolution.

Voluntary dissolution under statutory authority.—In most of the states the legislatures have enacted statutes allowing the voluntary dissolution of private corporations, and prescribing the mode in which such a dissolution may be effected. Such a statute, of course, is equivalent to acceptance by the legislature of the surrender of a charter, and no acceptance of a surrender is necessary.⁴⁸ In a few states dissolution may only be by unanimous consent of the members. In others it lies in the discretion of a court to grant a dissolution. In others the function of the court only extends to determining whether the provisions of the statute have been complied with. In some states upon the requisite vote

A. L. R. 1060 (semble); *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737.

⁴⁴ *Boston Glass Manufactory v. Langdon*, 24 Pick. (Mass.) 49, 35 Am. Dec. 292.

⁴⁵ *State v. Trustees of Vincennes University*, 5 Ind. 77, 87; *Combes v. Keyes*, 89 Wis. 297, 62 N. W. 89, 27 L. R. A. 369, 46 Am. St. Rep. 839.

⁴⁶ *Denike v. New York & R. Lime & Cement Co.*, 80 N. Y. 599, 606; *Barton v. Enterprise Loan & Building Ass'n*, 114 Ind. 226, 16 N. E. 486, 5 Am. St. Rep. 593.

⁴⁷ *Lauman v. Lebanon Val. R. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; *State v. Chilhowee Woolen Mills Co.*, 115 Tenn. 266, 89 S. W. 741, 2 L. R. A. (N. S.) 493, 112 Am. St. Rep. 825; *Wilson v. Proprietors of Central Bridge*, 9 R. I. 590; *Bowditch v. Jackson Co.*, 76 N. H. 351, 82 Atl. 1014, L. R. A. 1917A 1174, Ann. Cas. 1913A 366; *Warren*, 30 Harvard Law Rev. 335, 346.

⁴⁸ *Wilson v. Proprietors of Central Bridge*, 9 R. I. 590; *Fletcher, Corporations*, secs. 5453, 5457.

of the holders of a specified proportion of stock the dissolution takes place without any confirmatory court action.⁴⁹ It has been held that the power to dissolve given by statute is absolute and cannot be limited by the motives of the majority stockholders, such as the extinguishment of a contract burdensome to the majority. But the later decisions seem to limit the absolute character of the voting power of the majority stockholders when applied to dissolution under statutes, to protect the minority against fraud and oppression.⁵⁰

II. INVOLUNTARY DISSOLUTION BY JUDICIAL PROCEEDINGS.

§ 260. In general.—A corporation may forfeit its charter for misuser or nonuser, or for failure to perform conditions subsequent prescribed by its charter; but, as a rule, before the forfeiture can take effect, it must be judicially determined and declared in direct proceedings by or on behalf of the state.

A corporation may be dissolved by the forfeiture of its charter for misuser or nonuser of its franchises, or for failure to perform prescribed conditions subsequent, when the forfeiture has been judicially determined and decreed in proper proceedings by the attorney or solicitor general on behalf of the state.⁵¹ When it is

⁴⁹ See New York General Corporation Law, § 221 (two-thirds vote); Warren, Voluntary Transfers, 30 Harvard Law Rev. 347; Robotham v. Prudential Ins. Co. of America, 64 N. J. Eq. 673, 53 Atl. 842; Fain, Limitations of Statutory Power of Majority to Dissolve a Corporation, 25 Harvard Law Rev. 677.

⁵⁰ Paine v. Saulsbury, 200 Mich. 58, 166 N. W. 1036; Bowditch v. Jackson, 76 N. H. 351, 82 Atl. 1014, L. R. A. 1917A 1174, Ann. Cas. 1913A 366; J. H. Lane & Co. v. Maple Cotton Mills, 226 Fed. 692, 696; Allied Chemical & Dye Corporation v. Steele & Tube Co. of America, 14 Del. Ch. 1, 120 Atl. 486, 491; Kavanaugh v. Kavanaugh Knitting Co., 226 N. Y. 185, 123 N. E. 148; "In taking corporate action under the statute the stockholders are acting for the corporation and for each other, and they cannot use their corporate power in bad faith or for their individual advantage or purpose"; Riker & Son Co. v. United Drug Co., 79 N. J. Eq. 580, 82 Atl. 930, Ann. Cas. 1913A

1190. Cf. Windmuller v. Standard Distilling & Distributing Co., 115 Fed. 748; White v. Kincaid, 149 N. C. 415, 63 S. E. 109, 23 L. R. A. (N. S.) 1177, 128 Am. St. Rep. 663; 33 Yale Law Journal 436; 2 Minnesota Law Rev. 526; Fain, 25 Harvard Law Rev. 677, 683.

A court of equity will not permit the voluntary dissolution of a corporation, even on application of a majority of the stockholders where such dissolution is part of a scheme which would constitute a fraud on the minority. Riker v. United Drug Co., 79 N. J. Eq. 580, 82 Atl. 930, Ann. Cas. 1913A 1190.

⁵¹ Terrett v. Taylor, 9 Cranch (U. S.) 43, 51, 3 L. Ed. 650; Rex v. Amery, 2 Term R. 515; Commonwealth v. Union Fire & Marine Ins. Co. of Newburyport, 5 Mass. 230, 4 Am. Dec. 50; State v. Oberlin Building & Loan Ass'n, 35 Ohio St. 258; State v. Standard Life Ass'n, 38 Ohio St. 281; New York & Long Island Bridge Co. v. Smith, 148 N. Y. 540, 42 N. E. 1088; People v. North River Sugar

said that a corporation may forfeit its charter by misuser or non-user of its franchises, it is not meant that the misuser or nonuser results *ipso facto* in its dissolution. On the contrary, as a general rule, however long a corporation may fail to exercise the powers conferred upon it, or however much it may abuse them, a forfeiture of its charter can only take effect upon a judgment of a competent tribunal in proceedings instituted by authority of the state.⁵²

An intention on the part of the legislature that the failure of a corporation to comply with a condition subsequent shall *ipso facto* dissolve the corporation, instead of being merely a cause of forfeiture in direct proceedings by the state, will not be implied from language which will reasonably admit of a different construction, for it is not only the better policy to allow no one but the state to object to a corporation's failure to comply with conditions prescribed in its charter, but is also more in accord with justice, and with legal principles, to require legal proceedings by the state, in which the corporation may have a hearing, for the purpose of determining judicially whether the conditions prescribed in the charter have been complied with or not.⁵³ It is, however, within the power of the legislature to provide that certain omissions or acts shall operate to end their existence and to make such provisions self-executing. The language of the forfeiture clause must be strong and explicit to have this effect.⁵⁴

§ 261. Grounds for forfeiture of charter.

When a corporation has been guilty of acts or omissions of duty which, by its charter or some statute, are made an express cause of forfeiture of its franchise to be a corporation, and proceedings are instituted on behalf of the state to enforce the forfeiture, the court

Refining Co., 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843; *People ex rel. Attorney General v. Dashaway Ass'n*, 84 Cal. 114, 24 Pac. 227, 12 L. R. A. 117. See note in 8 Am. St. Rep. 179; *In re Opinion of the Justices*, 237 Mass. 619, 131 N. E. 29.

⁵² *Attorney General v. Superior & St. C. R. Co.*, 93 Wis. 604, 605, 67 N. W. 1138. See *State ex rel. Langer v. Gamble-Robinson Fruit Co.*, 44 N. D. 376, 176 N. W. 103, 9 A. L. R. 98; *State ex rel. Standard Oil Co. v.*

Blaisdell, 22 N. D. 86, 132 N. W. 769, Ann. Cas. 1913E 1089.

⁵³ See *New York & Long Island Bridge Co. v. Smith*, 148 N. Y. 540, 42 N. E. 1088; *People v. Hudson River Connecting R. Corporation*, 228 N. Y. 203, 126 N. E. 801.

⁵⁴ *Four-S-Razor Co. v. Guymon*, 110 Kan. 745, 205 Pac. 635; *Oakland Ry. Co. v. Oakland, B. & F. V. R. Co.*, 45 Cal. 365, 13 Am. Rep. 181. See *California Nat. Supply Co. v. Flack*, 183 Cal. 124, 190 Pac. 634; 11 *California Law Rev.* 40; *Fletcher, Corporations*, secs. 5427, 5443.

has no discretion to refuse a judgment of forfeiture.⁵⁵ But in other cases, where a corporation has merely violated its charter by doing unauthorized acts, or where it has been guilty of neglect, the court is vested with a discretion to determine whether judgment of ouster of the franchise to be a corporation shall be rendered, or whether the corporation shall merely be ousted from the exercise of the powers illegally assumed, or required to perform the duties neglected; and in determining this question it will consider both the interests and welfare of the public and the interests of stockholders and of creditors.⁵⁶

In an Alabama case, a corporation failed for a time to maintain its principal office or keep its books at the place required in the special act creating it. The president failed to make the first annual report to the state auditor. It did not appear, however, that the omissions were wilful or resulted in prejudice to any person. The breach of these charter provisions was not expressly made a cause of forfeiture by the act. It was held that courts are clothed with discretion as to declaring a forfeiture for any cause not expressly made a ground of forfeiture by the charter. The courts will refuse to declare a forfeiture where this would cause loss to the stockholders and no public interest requires it.⁵⁷

As a general rule, the charter of a corporation will not be forfeited for misuser, or for nonuser or neglect, unless it was wilful or fraudulent, or at least due to culpable negligence, or unless the legislature has expressly prescribed the penalty or forfeiture.⁵⁸

⁵⁵ *State v. Oberlin Building & Loan Ass'n*, 35 Ohio St. 258; *People v. Buffalo Stone & Cement Co.*, 131 N. Y. 140, 29 N. E. 947, 15 L. R. A. 240; *People v. Kankakee River Improvement Co.*, 103 Ill. 491.

⁵⁶ *State ex rel. Johnson v. Southern Building & Loan Ass'n*, 132 Ala. 50, 31 So. 375; *State v. Oberlin Building & Loan Ass'n*, 35 Ohio St. 258. See also, *State v. Standard Oil Co.*, 49 Ohio St. 137, 34 Am. St. Rep. 541; *State ex rel. Snyder v. Portland Natural Gas & Oil Co.*, 153 Ind. 483, 53 N. E. 1089, 53 L. R. A. 413, 74 Am. St. Rep. 314; *People v. Kankakee River Improvement Co.*, 103 Ill. 491, 510; *People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843.

⁵⁷ *State ex rel. Scott v. United States Endowment & Trust Co.*, 140 Ala. 610, 37 So. 442, 109 Am. St. Rep.

60. Compare *State v. Park & Nelson Lumber Co.*, 58 Minn. 330, 59 N. W. 1049. It is incumbent upon a private corporation organized under the laws of Minnesota to have its principal place of business and to keep its books in the state in which it is incorporated. A deliberate evasion for a long period justifies a forfeiture. It has even been held that this is a common-law obligation and a forfeiture may be adjudged for its violation. *State ex rel. Attorney General v. Milwaukee, L. S. & W. Ry. Co.*, 45 Wis. 579, 590. See *State ex rel. Chamberlain v. Public Drug Co.*, 41 S. D. 287, 170 N. W. 161 (annual reports required).

⁵⁸ *People v. Bristol & R. Turnpike Road*, 23 Wend. (N. Y.) 222, 236. See also, *People v. Atlantic Ave. R. Co.*, 125 N. Y. 513, 26 N. E. 622; *Paschall v. Whitsett*, 11 Ala. 472; *State v. Real Estate Bank*, 5 Ark.

And even when the abuse of its franchises by a corporation, or its neglect of duty, is wilful and fraudulent, the court will not necessarily give a judgment of forfeiture. The abuse or neglect must be such as to affect the public, for, if it affects purely private interests only, there are other remedies.⁵⁹ As Mitchell, J., has well said of proceedings in *quo warranto* to forfeit a corporate charter, "the object being to protect the public, and not to redress private grievances, the misuser must be such as to work or threaten a substantial injury to the public or such as to amount to a violation of the fundamental condition of the contract by which the franchise was granted, and thus defeat the purpose of the grant. . . . Courts always proceed with great caution in declaring a forfeiture of franchises. In view of the present condition of respondent's business, a dissolution of the corporation and a forced winding up of its affairs would involve new and additional loss to all parties concerned, both stockholders and creditors."⁶⁰

Misuser or abuse of franchises.—The charter of a private corporation may be forfeited, in proper proceedings by the state, for any willful or fraudulent misuser or abuse of its franchises which injures or menaces the interests or welfare of the state or of the community in which it transacts business. The misuser or abuse may consist in the exercise of a franchise or power not conferred

595, 41 Am. Dec. 109; *State ex rel. Attorney General v. Janesville Water Co.*, 92 Wis. 496, 66 N. W. 512, 32 L. R. A. 391; *State ex rel. Attorney General v. Northern Pac. R. Co.*, 157 Wis. 73, 147 N. W. 219.

⁵⁹ *State v. Minnesota Thresher Mfg. Co.*, 40 Minn. 213, 41 N. W. 1020, 3 L. R. A. 510; *Harris v. Mississippi Valley & Ship Island R. Co.*, 51 Miss. 602; *Commonwealth v. Arrison*, 15 Serg. & R. (Pa.) 127, 16 Am. Dec. 531; *State ex rel. Snyder v. Portland Natural Gas & Oil Co.*, 153 Ind. 483, 53 N. E. 1089, 53 L. R. A. 413, 74 Am. St. Rep. 314. See *People ex rel. Attorney General v. Dashaway Ass'n*, 84 Cal. 114, 24 Pac. 277, 13 L. R. A. 117; *State ex rel. Johnson v. Southern Building & Loan Ass'n*, 132 Atl. 50, 31 So. 375 (*ultra vires* act must be wilful, continued and serious to justify forfeiture of charter). See 8 Am. St. Rep. 180n; *People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33,

18 Am. St. Rep. 843: "Corporations may, and often do exceed their authority when only private rights are affected. . . . When these are adjusted all mischief ends and all harm is averted."

⁶⁰ *State v. Minnesota Thresher Mfg. Co.*, 40 Minn. 213, 41 N. W. 1020, 3 L. R. A. 510; *State ex rel. Attorney General v. Janesville Water Co.*, 92 Wis. 496, 66 N. W. 512, 32 L. R. A. 391 (forfeiture of the franchise of a solvent, active corporation supplying the necessities of many people and whose securities are held by innocent persons, will not be decreed in the absence of clear, wilful misuse, abuse or nonuse of its franchises. Eight years' delay will estop the state from forfeiting for overbonding and issuing stock without payment. Waiver may also arise from compulsion to extend the waterworks); *Illinois Trust & Savings Bank v. Doud*, 105 Fed. 123, 52 L. R. A. 481, aff'g 89 Fed. 235.

upon the corporation by its charter, or in the violation of prohibitions in its charter, or in the violation of prohibitions in general laws to which it is subject, or in the violation of established principles of public policy.⁶¹ For example, it has been held or said to be a ground of forfeiture for an insurance company to carry on the business of banking in violation of a general law prohibiting unauthorized banking;⁶² for a corporation to hire lawyers to carry on the business of practicing law for it;⁶³ for a bank to contract debts or issue bills to a greater amount than is allowed by its charter, or fraudulently to issue more paper than it can redeem,⁶⁴ for a corporation to enter into an unauthorized and unlawful combination with other corporations, or with corporations and natural persons, for the purpose of preventing competition and creating a monopoly;⁶⁵ or for a medical college, conducting its business for pecuniary

⁶¹ *People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843; *State v. Standard Life Ass'n*, 38 Ohio St. 281; *State Bank of Vincennes v. State*, 1 Blackf. (Ind.) 267, 12 Am. Dec. 234; *State v. Debenture Guarantee & Loan Co.*, 51 La. Ann. 1874, 26 So. 600; *People v. Rosenstein-Cohn Co.*, 131 Cal. 153, 63 Pac. 163.

⁶² See *People v. Utica Ins. Co.*, 15 Johns. (N. Y.) 353, 358, 8 Am. Dec. 243.

⁶³ In *People ex rel. Los Angeles Bar Ass'n v. California Protective Corporation*, — Cal. App. —, 244 Pac. 1089, a proceeding in *quo warranto* was brought by the attorney general, in the name of the people, upon the complaint of the Los Angeles Bar Association to oust a corporation from its franchises and from the practice of law. The court said: "A proceeding in the nature of *quo warranto* is the proper remedy in this case. The right to practice law 'is in the nature of a franchise from the state,' says the court in *Re Cooperative Law Co.*, 198 N. Y. 479, 92 N. E. 15, 32 L. R. A. (N. S.) 55, 139 Am. St. Rep. 839, 19 Ann. Cas. 879. When a corporation is assuming to exercise a privilege or franchise which it is unlawful for it to exercise, a proceeding in *quo warranto* lies to secure a judgment of ouster and seizure of its franchises. In *People ex rel. Attorney*

General v. Dashaway Ass'n, 84 Cal. 117, 24 Pac. 278, 12 L. R. A. 117, it is said that when corporations 'do acts which are not authorized or are forbidden them to do, the state may forfeit their franchises and dissolve them by an information in the nature of a *quo warranto*.' "

⁶⁴ *State Bank of Vincennes v. State*, 1 Blackf. (Ind.) 267, 12 Am. Dec. 234.

⁶⁵ *People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843; *People v. Milk Exchange*, 145 N. Y. 267, 39 N. E. 1062, 27 L. R. A. 437, 45 Am. St. Rep. 609; *State v. Standard Oil Co.*, 49 Ohio St. 137, 30 N. E. 279, 15 L. R. A. 145, 34 Am. St. Rep. 541; *State ex rel. Snyder v. Portland Natural Gas & Oil Co.*, 153 Ind. 483, 53 N. E. 1089, 53 L. R. A. 413, 74 Am. St. Rep. 314; *Distilling & Cattle Feeding Co. v. People*, 156 Ill. 448, 41 N. E. 188, 47 Am. St. Rep. 200; *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319; *State v. Nebraska Distilling Co.*, 29 Neb. 700, 46 N. W. 155; *State v. Central Lumber Co.*, 24 S. D. 136, 123 N. W. 504, 42 L. R. A. (N. S.) 804; *Nekoosa-Edwards Paper Co. v. News Pub. Co.*, 174 Wis. 107, 182 N. W. 919; *State ex rel. Langer v. Gamble-Robinson Fruit Co.*, 44 N. D. 376, 176 N. W. 103, 9 A. L. R. 98.

profit, to confer degrees and issue diplomas for a price, without regard to the qualification of the applicant to practice medicine, and sometimes without any examination at all.⁶⁶

Nonuser of franchises, suspension of business.—It has been said that it is an implied condition of every corporate charter that the grantees shall act thereunder up to the expiration of the time for which they are incorporated, and if they fail to do so, the franchises granted may be withdrawn. And, as a general proposition, this is true.⁶⁷ It has been held, however, that the charter of a corporation should not be forfeited for nonuser unless it affects matters which are of the essence of the contract between it and the state,⁶⁸ nor for “acts of nonuser that do not amount to willful and repeated violations of the contract between the corporation and the state.”⁶⁹ The charter of a public service corporation may certainly be forfeited in proper proceedings for willful nonuser of its franchises, to the injury or prejudice of the public, for neglect to perform duties imposed upon it for the benefit of the public, or for rendering itself unable to perform such duties.⁷⁰

§ 262. Acts and neglects of officers or stockholders as acts and neglects of corporation.

When proceedings are instituted by the state to forfeit the charter of a corporation for *ultra vires* acts or improper neglect, the acts and neglects of its directors, trustees, or other managing officers, as such, though willful, are imputable to the corporation.⁷¹ A different rule applies to acts of subordinate officers or agents

⁶⁶ *Independent Medical College v. People*, 182 Ill. 274, 55 N. E. 345; *Illinois Health University v. People ex rel. Moloney*, 166 Ill. 171, 46 N. E. 737. See 46 A. L. R. 1478n.

⁶⁷ *State v. New Orleans Gas Light & Banking Co.*, 2 Rob. (La.) 529. See also, *Darnell v. State*, 48 Ark. 321, 3 S. W. 365; *Chesapeake & O. Canal Co. v. Baltimore & O. R. Co.*, 4 Gill & J. (Md.) 1. See *Darling v. Service Transp. Corporation*, 118 N. Y. Misc. 811, 194 N. Y. Supp. 902; *Ewen v. American Fidelity Co.*, 271 Fed. 848 (Illinois statute).

⁶⁸ *Harris v. Mississippi Val. & S. I. R. Co.*, 51 Miss. 602. And see *State v. Farmers' College*, 32 Ohio St. 487; *State v. Council Bluffs & N. Ferry Co.*, 11 Neb. 354, 9 N. W. 563.

⁶⁹ *State v. Societe Republicaine*, 9 Mo. App. 114. And see *State v. Pawtuxet Turnpike Corp.*, 8 R. I. 182.

⁷⁰ *Washington & B. Turnpike Co. v. Maryland*, 3 Wall. (U. S.) 210, 18 L. Ed. 180; *Darnell v. State*, 48 Ark. 321, 3 S. W. 365; *Ward v. Farwell*, 97 Ill. 593; *Henderson Loan & Real Estate Ass'n v. People ex rel. Cobb*, 163 Ill. 196, 45 N. E. 141; *People v. Plainfield Ave. Gravel-Road Co.*, 105 Mich. 9, 62 N. W. 998.

⁷¹ *Angell & Ames, Corporations*, § 310. See also, *Bank Commissioners v. Bank of Buffalo*, 6 Paige (N. Y.) 497; *Ward v. Sea Ins. Co.*, 7 Paige (N. Y.) 297; *State Bank of Vincennes v. State*, 1 Blackf. (Ind.) 267, 12 Am. Dec. 234.

not authorized or directed by the stockholders or directors. The charter of a corporation will not be forfeited for the acts of the managing agent in violation of his instructions, and without the consent or knowledge of the corporation.⁷²

As we have seen in a former chapter, a corporation and its stockholders are separate and distinct persons in the law for the purpose of making contracts, taking, holding, and conveying property, and suing and being sued. For these purposes, the acts of the stockholders are not the acts of the corporation. This, however, is a mere legal privilege, and, when it is urged to an intent and purpose not within its reason, the courts will disregard it, even at law, and, looking behind the legal entity, will recognize the fact that the corporation is a collection of individuals. It has been held, therefore, that, where all the stockholders of a corporation, by transferring their shares to a committee or trustee, although acting individually, bring the corporation into an *ultra vires* and illegal trust or combination with other corporations, such acts of the stockholders will be regarded as the act of the corporation, when the trust or combination is made the basis of proceedings to forfeit its charter.⁷³

§ 263. Waiver of forfeiture by the state, and delay in instituting proceedings.

It is well settled that when a corporation, by nonuser or misuser of its franchises, has rendered its charter and franchises liable to forfeiture in a proper proceeding by the state, the cause of forfeiture may be waived by the state. The same is true where a corporation has rendered its charter liable to forfeiture by failure to comply with conditions subsequent prescribed in its charter, even when failure to comply therewith is expressly declared by the charter to be a cause of forfeiture and dissolution. And after such a waiver, neither the state nor individuals can set up or enforce a forfeiture.⁷⁴ If, however, the corporation is *ipso facto*

⁷² Tuscaloosa Scientific & Art Ass'n v. State, 58 Ala. 54.

⁷³ People v. North River Sugar Refining Co., 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843. See also, State v. Standard Oil Co., 49 Ohio St. 137, 30 N. E. 279, 15 L. R. A. 145, 34 Am. St. Rep. 541; People ex rel. Peabody v. Chicago Gas Trust Co., 130 Ill. 263, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319;

Distilling & Cattle Feeding Co. v. People, 156 Ill. 448, 41 N. E. 188, 47 Am. St. Rep. 200; State v. Nebraska Distilling Co., 29 Neb. 700, 46 N. W. 155.

⁷⁴ State v. Fourth New Hampshire Turnpike, 15 N. H. 162, 41 Am. Dec. 690; People v. Phoenix Bank, 24 Wend. (N. Y.) 431, 35 Am. Dec. 634; In re New York El. Ry. Co., 70 N. Y. 327.

dissolved, and its franchises absolutely terminated by such failure, the corporation, when it fails to perform the condition, ceases to exist, and the doctrine of waiver of forfeiture cannot apply.⁷⁵

Waiver of a forfeiture by the legislature need not necessarily be expressly declared in a statute, but it may be implied. As a general rule, it will be implied from acts of the legislature recognizing the subsequent and continued existence of the corporation as legal,—as from an act ratifying acts done by the corporation after the cause of forfeiture arose, as a transfer of property or privileges,⁷⁶ or from an act granting additional powers, or extending the time for performing conditions subsequent.⁷⁷

Mere acquiescence by the public in the violation of its charter by a corporation, or mere lapse of time before commencement of proceedings to enforce a forfeiture, where there has been no express waiver, and no recognition of the continued existence of the corporation as legal, will not generally operate as a waiver of the cause of forfeiture, so as to bar a proceeding by the state.⁷⁸

Who may waive a forfeiture.—As a general rule, no one can waive a forfeiture of its charter by a corporation except the state.⁷⁹ Furthermore, waiver of a forfeiture of its charter and franchises by a corporation, like the creation of a corporation, is a legislative act, and is not within the power of any executive or judicial officer of the state, nor within the power of any body of men other than the legislature. A forfeiture, therefore, cannot be waived by the governor and the senate alone, for the act of the senate alone is not the act of the legislature.⁸⁰ It has been held,

⁷⁵ *State v. Fourth New Hampshire Turnpike*, 15 N. H. 162, 41 Am. Dec. 690. See, however, *Farnsworth v. Lime Rock R. Co.*, 83 Me. 440, 22 Atl. 373.

⁷⁶ *State v. Centreville Bridge Co.*, 18 Ala. 678.

⁷⁷ *State v. Fourth New Hampshire Turnpike*, 15 N. H. 162, 41 Am. Dec. 690. See also, *Enfield Toll Bridge Co. v. Connecticut River Co.*, 7 Conn. 28; *People v. Mississippi & A. R. Co.*, 14 Ill. 440; *People v. Ottawa Hydraulic Co.*, 115 Ill. 281, 3 N. E. 413; *Farnsworth v. Lime Rock R. Co.*, 83 Me. 440, 22 Atl. 373; *Attorney General v. Superior & St. C. R. Co.*, 93 Wis. 604, 67 N. W. 1129.

⁷⁸ *State v. Pawtuxet Turnpike Co.*, 8 R. I. 521, 94 Am. Dec. 123; *People*

ex rel. Moloney v. Pullman's Palace Car Co., 175 Ill. 125, 51 N. E. 664, 64 L. R. A. 366. Compare, however, *State ex rel. Attorney General v. Janesville Water Co.*, 92 Wis. 496, 66 N. W. 512, 32 L. R. A. 391; *State v. Bailey*, 19 Ind. 452. But see *Attorney General ex rel. Ruggles v. Buckley & Douglas Lumber Co.*, 164 Mich. 625, 180 N. W. 200.

⁷⁹ *People v. Phoenix Bank*, 24 Wend. (N. Y.) 431, 35 Am. Dec. 634; *Chicago City Ry. Co. v. People*, 73 Ill. 541.

⁸⁰ *People v. Phoenix Bank*, 24 Wend. (N. Y.) 431, 35 Am. Dec. 634. It was pointed out in this case that the attorney general has more power than the governor or the senate united; for if he refused to prosecute

however, that where conditions subsequent, express or implied, are required to be performed by a corporation solely for the benefit of a municipal corporation, its acts may be relied upon as a waiver of the right to enforce a forfeiture for failure to perform the condition.⁸¹

III. PROCEDURE AND JURISDICTION.

§ 264. In general.—At common law, a proceeding to forfeit the charter of a corporation is either by *scire facias*, or by an information in the nature of *quo warranto*, instituted and prosecuted by the attorney general on behalf of the state. In most jurisdictions, however, the mode of procedure is now prescribed by statute.

As a general rule, in the absence of a statute, a court of equity has no jurisdiction to decree a forfeiture of the charter of a corporation, or otherwise dissolve it, either in a suit by the attorney general on behalf of the state, or in a suit by the corporation itself, or by stockholders or creditors. In some states, however, such jurisdiction has been recognized in recent cases where the legal remedies are inadequate.

At common law, the mode of proceeding against a corporation to enforce a forfeiture of its charter, or to oust it from the unauthorized exercise of corporate powers, was by *scire facias*, or by an information by the attorney general in the nature of the writ of *quo warranto*. Formerly *scire facias* was the proper remedy where there was a legally existing body capable of acting, but which had been guilty of an abuse of its powers and franchises, and it is still so in some jurisdictions,⁸² while *quo warranto* was the proper remedy where a body undertook to act as a corporation without legal authority. In the latter case, *scire facias* would not lie. In this country, an information in the nature of *quo warranto*, brought by the attorney general in the name and on behalf of the state, is now the proper remedy in most jurisdictions in all cases, except where some statutory remedy has been substituted, whether

the corporation would continue to exist and to enjoy its privileges in the same manner as if there had been no violation of the charter. But the neglect to prosecute would not amount to a pardon.

⁸¹ State ex rel. Attorney General v. Janesville Water Co., 92 Wis. 496, 66 N. W. 512, 32 L. R. A. 391.

⁸² Rex v. Pasmore, 3 Term R. 199; Slee v. Bloom, 5 Johns. Ch. (N. Y.) 366; Washington & B. Turnpike Road v. State, 19 Md. 239; People ex rel. Attorney General v. Dashaway Ass'n, 84 Cal. 114, 24 Pac. 436, 12 L. R. A. 117; Wheeler v. Pullman Iron & Steel Co., 143 Ill. 197, 32 N. E. 420, 17 L. R. A. 818.

there is a legal corporation which has forfeited its right to continue, or merely a *de facto* corporation exercising corporate powers without authority.⁸³

A proceeding to enforce a forfeiture of the charter of a corporation is instituted by the attorney general in the name of the state. It cannot be instituted and prosecuted by private individuals, nor even by the attorney or solicitor general, if he is acting solely on behalf of private individuals, and not *ex officio* on behalf and by authority of the state.⁸⁴ The attorney general cannot be compelled by *mandamus* to institute *quo warranto* or other proceedings to forfeit the charter of a corporation.⁸⁵

It was formerly the general rule that a court of equity has no authority, at the suit of a stockholder, to decree a dissolution of a corporation or even to wind up its affairs, unless such authority has been conferred by statute.⁸⁶ The trend of the more recent judicial opinion is that dissension among stockholders if such as to defeat the end and purpose and success of the enterprise will be ground for equitable relief even to the extent of dissolution to protect minority stockholders.⁸⁷

As the Wisconsin court says: "There is now a respectable array of judicial authority to the proposition that where a corporation has been plundered by its officers, or they have so managed its affairs as to bring it to the verge of bankruptcy, threatening the

⁸³ *People v. Kankakee River Improvement Co.*, 103 Ill. 491; *Wheeler v. Pullman Iron & Steel Co.*, 143 Ill. 197, 32 N. E. 420, 17 L. R. A. 818; *State v. Fourth New Hampshire Turnpike*, 15 N. H. 162, 41 Am. Dec. 690; *People v. Phoenix Bank*, 24 Wend. (N. Y.) 431, 35 Am. Dec. 634; *State ex rel. Snyder v. Portland Natural Gas Co.*, 153 Ind. 483, 53 N. E. 1089, 53 L. R. A. 413, 74 Am. St. Rep. 314; *State v. Oberlin Building & Loan Ass'n*, 35 Ohio St. 258; *People ex rel. Attorney General v. Dashaway Ass'n*, 84 Cal. 114, 24 Pac. 436, 12 L. R. A. 117.

⁸⁴ *Commonwealth v. Union Fire & Marine Ins. Co.*, 5 Mass. 230, 4 Am. Dec. 50. See also, *Ross v. Chicago, B. & Q. R. Co.*, 77 Ill. 127; *People v. North Chicago Ry. Co.*, 88 Ill. 537; *Heap v. Heap Mfg. Co.*, 97 Mich. 147, 56 N. W. 349.

It is competent, of course, for the legislature to confer upon private individuals authority to institute pro-

ceedings against a corporation to determine and declare a forfeiture of its charter, and it has done so in some jurisdictions. See *State v. Consolidation Coal Co.*, 46 Md. 1; *Tuscaloosa Scientific & Art Ass'n v. State*, 58 Ala. 54; *Hunt v. Le Grand Roller Skating Rink Co.*, 143 Ill. 118, 32 N. E. 525.

⁸⁵ *State v. Attorney General*, 30 La. Ann. 954; *State v. Paterson & H. Turnpike Co.*, 21 N. J. Law 9.

⁸⁶ See ante, § 253; *Myers v. Occidental Oil Corporation*, 288 Fed. 997, 1003.

⁸⁷ *Green v. National Advertising & Amusement Co.*, 137 Minn. 65, 162 N. W. 1056, L. R. A. 1917E 784; *Warner v. Bonds*, 111 Ark. 238-247, 163 S. W. 788; *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, 53 N. W. 218, 17 L. R. A. 412; *Brent v. B. E. Brister Sawmill Co.*, 103 Miss. 876, 60 So. 1018, 43 L. R. A. (N. S.) 720, Ann. Cas. 1915B 576; *Dill v. Johnston*, 72 Okla. 149, 179 Pac. 608.

minority stockholders with loss of their investment, and it seems certain that the purposes for which the corporation was organized are no longer attainable, and there is no other adequate remedy, a court of equity, in the exercise of its inherent power, will appoint a receiver for the corporation, wind up its affairs, distribute its assets, and decree a dissolution thereof at the suit of a minority stockholder.”⁸⁸

§ 265. Statutory jurisdiction to dissolve corporations.

In most jurisdictions, if not in all, statutes have been enacted providing the method of forfeiting the charters of corporations for misuser or nonuser of their franchises, or for other specified causes, and giving jurisdiction of proceedings for this purpose to particular courts. Generally the statutory proceeding to forfeit the charter of a corporation is an information in the nature of *quo warranto* by the solicitor or attorney general in his official name, or in the name of the state or the people; but sometimes a different mode of procedure is provided. In some states, by statute, proceedings to forfeit the charter of a corporation may be brought in the name of the state on the relation of private individuals, or by a private individual in his own name.⁸⁹

In some states, jurisdiction has been conferred by statute upon courts of equity, or other courts, where the distinction between courts of law and equity has been abolished, to decree a dissolution of a corporation and to wind up its affairs, in specified cases, at the suit of individual stockholders, or of creditors, and the jurisdiction of the courts under such statutes has been upheld.⁹⁰

IV. EFFECT OF DISSOLUTION.

§ 265a. In general.—When a corporation has been legally dissolved,

- (1) It cannot afterwards sue or be sued, or otherwise act as a corporate body.

⁸⁸ Goodwin v. Von Cotzhausen, 171 Wis. 351, 177 N. W. 618. See 43 A. L. R. 242 note.

⁸⁹ Such a statute is not unconstitutional. Hunt v. Le Grand Roller Skating Rink Co., 143 Ill. 118, 32 N. E. 525. See People ex rel. Seemann v. Greer College, 302 Ill. 538, 135 N. E. 80; People ex rel. Attorney

General v. Dashaway Ass'n, 84 Cal. 114, 24 Pac. 277, 12 L. R. A. 117.

⁹⁰ Wheeler v. Pullman Iron & Steel Co., 143 Ill. 197, 32 N. E. 420, 17 L. R. A. 818; Hunt v. Le Grand Roller Skating Rink Co., 143 Ill. 118, 32 N. E. 525; Abbott v. Loving, 303 Ill. 154, 135 N. E. 442.

- (2) Debts due to or by the corporation are not extinguished. Even in the absence of a statute, a court of equity will collect debts due to a corporation for the benefit of creditors and stockholders, and will satisfy debts due by the corporation out of its assets.
- (3) The property of the corporation belongs to the stockholders subject to the corporate debts. In the absence of a statute, a court of equity, in the case of modern business corporations, will apply their assets to the payment of their debts, and distribute what remains among their stockholders.
- (4) At common law, actions pending at the time of its dissolution abate. This rule also has been changed to some extent by statute.

When a corporation is dissolved by an absolute repeal of its charter, by expiration of the time limited in its charter, by a surrender of its charter accepted or authorized by the legislature, by a valid judgment forfeiting its charter, or in any other legal mode, it no longer exists for any purpose, unless there is some statutory provision continuing its existence, and therefore, it no longer has any capacity or power either to enter into contracts, take, hold, or convey property, sue or be sued, or to exercise any other franchise or power conferred upon it by its charter. Like a dead natural person, it has ceased to have any existence.⁹¹ By statutes in most states the directors in office at the time of dissolution are empowered to collect the assets, pay liabilities and distribute the surplus to the stockholders. Suits may be brought, continued or defended by them, and other acts done so far as necessary for winding up the corporate enterprise.

§ 266. Effect of dissolution with respect to debts and contracts.

It was once supposed to be the common-law rule that, on the dissolution of a corporation, all the debts due either by or to the corporate body were extinguished, and this rule has been recog-

⁹¹ *Greenwood v. Union Freight R. Co.*, 105 U. S. 13, 26 L. Ed. 961; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32; *People v. O'Brien*, 45 Hun (N. Y.) 519, rev'd 111 N. Y. 1, 18 N. E. 692, 2 L. E. A. 255, 7 Am. St. Rep. 684; *Bradley v. Rep-*

pell, 133 Mo. 545, 32 S. W. 645, 34 S. W. 841, 54 Am. St. Rep. 685; *Read v. Frankfort Bank*, 23 Me. 318; *Brandon v. Umpqua Lumber & Timber Co.*, 166 Cal. 322, 136 Pac. 62; *Van Landingham v. United Tuna Packers Co.*, 189 Cal. 353, 208 Pac.

nized in a few cases in this country.⁹² It still seems to be the view of the English common law that a corporation, unlike a natural person, can have no heir or legal successor or even a personal representative like an administrator to pay its debts out of its former estate.⁹³ But in American law generally when the stockholders cease to hold in their corporate capacity, they then hold in their individual capacity as tenants in common. The creditors may enforce their claims against the property of the corporation at the time of its dissolution in equity or in any other mode which may be provided. While debts due to or by a corporation cannot be enforced at law after its dissolution, for want of a person to sue or be sued, they are not extinguished in equity; and a court of equity, where no other remedy is provided by statute, will, by the appointment of a receiver, collect all debts which were due to the corporation at the time of its dissolution, or afterwards maturing, as a part of its assets, and apply its assets in payment of debts due by it.⁹⁴

973, noted in 11 California Law Rev. 40; 32 Yale Law Journal 187; 47 A. L. R. 1288a.

⁹² "The debts of a corporation, either to or from it," says Blackstone, "are totally extinguished by its dissolution; so that the members thereof cannot recover, or be charged with them, in their natural capacities." 1 Bl. Com. 484. See also, *Rider v. Nelson & Albemarle Union Factory*, 7 Leigh (Va.) 156, 30 Am. Dec. 495; *Commercial Bank v. Lockwood's Adm'r*, 2 Har. (Del.) 8; *White v. Campbell*, 5 Humph. (Tenn.) 38; *State Bank of Vincennes v. State*, 1 Blackf. (Ind.) 267, 12 Am. Dec. 234; *Coulter v. Robertson*, 24 Miss. 278; *Bank of Mississippi v. Duncan & Marshall*, 56 Miss. 166; *Fox v. Horah*, 1 Ired. Eq. (N. C.) 358, 36 Am. Dec. 48, expressly overruled in *Wilson v. Leary*, 120 N. C. 90, 26 S. E. 630, 38 L. R. A. 240, 58 Am. St. Rep. 778.

Professor Williston points out that Blackstone overlooked an equity case (*Taylor v. Brown*, Finch 83), which held that creditors could proceed in equity to reclaim from members of a dissolved corporation property which had belonged to it, and that debts due from the corporation should be paid therefrom. 3 Williston, Contracts, sec. 1960.

⁹³ *Higginson & Dean, L. R.* [1899] 1 Q. B. Div. 325. A bank which was a creditor of a bankrupt trading firm proved its claim in bankruptcy. The bank was later dissolved by an order of court. Afterwards certain other assets of the bankrupt were discovered. Another creditor moved to strike out the claim of the dissolved corporation, but the attorney general claimed the proceeds for the crown as *bona vacantia*, and it was held that the crown was entitled to the amount. See 12 Harvard Law Rev. 558; 19 Harvard Law Rev. 610; 47 A. L. R. 1349n.

⁹⁴ *Bacon v. Robertson*, 18 How. (U. S.) 480, 15 L. Ed. 499; *Curran v. Arkansas*, 15 How. (U. S.) 304, 310, 14 L. Ed. 705; *Mumma v. Potomac Co.*, 8 Pet. (U. S.) 281, 8 L. Ed. 945; *In re Mullings Clothing Co.*, 238 Fed. 58, L. R. A. 1918 A 539; s. c., 252 Fed. 667; *Griffith v. Blackwater Boom & Lumber Co.*, 46 W. Va. 56, 33 S. E. 125; *Huber v. Martin*, 127 Wis. 412, 105 N. W. 1031, 3 L. R. A. (N. S.) 653, 115 Am. St. Rep. 1023, 7 Ann. Cas. 400. See *Bolles v. Crescent Drug & Chemical Co.*, 53 N. J. Eq. 614, 32 Atl. 1061 (statute); *City of New York v. New York & S. B. Ferry & Steam Transp. Co.*, 231 N. Y. 18, 131 N. E. 554.

Executory contracts.—According to the modern doctrine, liabilities of a corporation under *executory contracts* are not extinguished by its dissolution. This is undoubtedly true where the dissolution is voluntary, and some courts have applied the rule to involuntary dissolution.⁹⁵ In the nature of things, specific performance cannot be compelled by the other party, but he is entitled to damages for nonperformance, and such liability on the part of the corporation may be enforced in equity against the property of the corporation.⁹⁶ In some cases, however, it is held that employment contracts are terminated by involuntary dissolution or receivership. And in accordance with this principle it was held in a New York case that, where a general agent of a life insurance company was engaged by the company for five years at a stipulated salary, but, before the expiration of the five years, the company was enjoined from doing business, and a receiver was appointed, in proceedings instituted by the state superintendent of the insurance department, and prosecuted by the attorney general, the contract of employment was discharged by the action of the state, and the agent had no claim upon the assets of the company in the receiver's hands for damages for alleged breach of the contract.⁹⁷ The idea seems to be that while receivership does not

⁹⁵ *Shields v. Ohio*, 95 U. S. 319, 324, 24 L. Ed. 357; *People v. National Trust Co.*, 82 N. Y. 283 (covenant to pay rent continues); *Schleider v. Dielman*, 44 La. Ann. 462, 10 So. 934; *Okmulgee Window Glass Co. v. Frink*, 260 Fed. 159; *Kalkhoff v. Nelson*, 60 Minn. 284, 62 N. W. 332 (voluntary dissolution); *Bowe v. Minnesota Milk Co.*, 44 Minn. 460, 47 N. W. 151; 47 A. L. R. 1368n.

⁹⁶ *Schleider v. Dielman*, 44 La. Ann. 462, 10 So. 934, and other cases in the note preceding. See *Reigate v. Union Mfg. Co.*, [1918] 1 K. B. 592.

⁹⁷ *People v. Globe Mut. Life Ins. Co.*, 64 How. Pr. (N. Y.) 240, 91 N. Y. 174. And see *Griffith v. Blackwater Boom & Lumber Co.*, 46 W. Va. 56, 33 S. E. 125; *Bracken v. William & Mary College*, 1 Call (Va.) 161; s. c., 55 W. Va. 604, 48 S. E. 442, 69 L. R. A. 124; *Du Pont v. Standard Arms Co.*, 9 Del. Ch. 315, 81 Atl. 1089; *United States v. Poe*, 120 Md. 89, 87 Atl. 933; *Lenoir v. Linville Imp. Co.*, 126 N. C. 922, 36 N. E. 185, 51 L. R. A. 146; *Law v. Wald-*

ron, 230 Pa. 458, 79 Atl. 647, Ann. Cas. 1912 A 467; *Williamson County Banking & Trust Co. v. Roberts-Buford Dry Goods Co.*, 118 Tenn. 340, 345, 101 S. W. 421, 9 L. R. A. (N. S.) 644, 12 Ann. Cas. 579. See note 3 A. L. R. 627, appointment of receiver as excuse for nonperformance of contract.

An idea which may influence the courts in these cases is that justice is better served if recovery is allowed only for such part of the employment contract as has been performed, but not for profits which would have arisen from future performance. Creditors who have actually furnished value or given an executed consideration have perhaps a stronger claim than those who have agreed to render services and have merely lost an opportunity to earn future profits by the enforced suspension of the corporate business. See *Chas. P. Hine*, 24 Yale Law Journal 111, 126, effect of receivership. See *Shumate v. Shonon*, 12 Fed. (2d) 825 (D. C.). Death of a partner dissolves a partnership and terminates a contract of

dissolve the corporation, yet in the case of contracts of employment it amounts to legal prevention, and has the same effect as the death of the employer. There is found an "implied condition" that the contract shall terminate in such event.

In some jurisdictions, however, there are decisions to the contrary. It was held in a New Jersey case that the dissolution of a corporation having a capital stock, by a judgment in proceedings to forfeit its charter, did not discharge a contract by which a person was employed by the corporation for a term, and that he could enforce his claim for damages for the term of his contract unexpired at the time of the forfeiture.⁹⁸ As Professor Williston points out, the ordinary cause for compulsory dissolution is the financial condition of the company, and the bankruptcy or the appointment of a receiver on account of insolvency, though it may operate as legal prevention of performance, is due to a cause for which the corporation is responsible, as in the case of voluntary dissolution.⁹⁹

§ 267. Effect of dissolution with respect to property.

It has repeatedly been said by text-writers and judges, and has been directly held in some of the cases, that, at common law, upon the dissolution of a corporation, all its real estate reverts to the grantors or donors or their heirs, and all its personal estate goes to the king, or, in this country, to the state as goods without any owner; and in some late cases this doctrine has been applied in this country, in equity as well as at law, to some kinds of corporations. It is very doubtful, however, whether there is any real authority for the doctrine that the real estate of a corporation

employment of a general manager, which is dependent on the life of the employee and the life of the partnership.

⁹⁸ Napier v. People's Stores Co., 98 Conn. 414, 120 Atl. 295, 33 A. L. R. 499, 508n; Rosenbaum v. United States Credit System Co., 61 N. J. Law 543, 40 Atl. 591, rev'g 60 N. J. Law 294, 37 Atl. 595. See Bijur v. Standard Distilling & Distributing Co., 74 N. J. Eq. 546, 70 Atl. 934; Spader v. Mural Decoration Mfg. Co., 47 N. J. Eq. 18, 20 Atl. 378; Isaac McLean Sons Co. v. William S. Butler & Co., 227 Fed. 325; Milton v. Bank of Newborn, 30 Ga. App. 55, 116 S. E.

861; Lewis v. Atlas Mut. Life Ins. Co., 61 Mo. 534. In re Rouden Mfg. Co., Inc., 278 Fed. 663.

⁹⁹ 3 Williston, Contracts, sec. 1960, citing Central Trust Co. of Illinois v. Chicago Auditorium Ass'n, 240 U. S. 581, 60 L. Ed. 811, 36 Sup. Ct. 412, L. R. A. 1917 B 580; Bolles v. Crescent Drug & Chemical Co., 53 N. J. Eq. 614, 32 Atl. 1061. See 8 Minnesota Law Rev. 63. It is said by the United States Supreme Court to be an implied condition in every contract that the promisor will not permit himself (or itself) to be disabled by insolvency or bankruptcy proceedings.

reverts to the donors or grantors, or their heirs.¹⁰⁰ In a recent English case it was held that a lease to a corporation for a term of years terminates if the corporation is dissolved without having assigned the lease. The reversion is thereby accelerated and the land reverts to the lessor. The liability of the sureties of the tenant for the rent is thus ended.¹⁰¹ American courts, however, hold that a lease to a corporation is not terminated by a dissolution of the corporation. The stockholders succeed to the rights of the corporation in the leasehold as tenant or owners in common, subject, however, to all obligations imposed on the lessee by the terms of the lease. The covenant to pay rent is not discharged.¹⁰²

Modern rule as to business corporations. The old common-law rule has been repudiated in this country.—On the dissolution of a modern business corporation, whether by expiration of its charter, by a judgment of forfeiture, or otherwise, it is considered in equity, even in the absence of any statute, that its assets are held for the benefit of its stockholders or members, after payment of its debts, and will be so distributed by a court of equity when no other mode of distribution is provided by statute.¹⁰³ In such a case the

¹⁰⁰ The doctrine has been laid down or applied in the following text books and cases, among others: Co. Litt. 13b; 1 Bl. Com. 484; 2 Kent, Com. 385; *White v. Campbell*, 5 Humph. (Tenn.) 38; *People v. Trustees of College of California*, 38 Cal. 166; *Owen v. Smith*, 31 Barb. (N. Y.) 641, 645; *Titcomb v. Kennebunk Mut. Fire Ins. Co.*, 79 Me. 315, 9 Atl. 732; *State Bank of Vincennes v. State*, 1 Blackf. (Ind.) 267, 12 Am. Dec. 234; *Life Ass'n of America v. Fassett*, 102 Ill. 315; *Mott v. Danville Seminary*, 129 Ill. 403, 21 N. E. 927; *Danville Seminary v. Mott*, 136 Ill. 289, 28 N. E. 54; *Cp. County of Franklin v. Blake*, 283 Ill. 292, 119 N. E. 288; *Late Corporation of Church of Jesus Christ of Latter-Day Saints v. United States*, 136 U. S. 1, 34 L. Ed. 478, 10 Sup. Ct. 792. See 47 A. L. R. 1328n.

This doctrine is based upon a statement of Lord Coke. Co. Litt. 13b. Professor Gray, however, in his work on the "Rule against Perpetuities," expresses doubt as to its soundness, pointing out that the only justification for Lord Coke's assertion is a mere dictum of Choke, J., in the Prior

of *Spalding's Case*, 7 Edw. IV. 10-12. Gray, *Perpetuities*, §§ 44-51a. It is referred to in a note in the *Harvard Law Review*, on the authority of Professor Gray, as "the long-prevalent but erroneous notion that real estate remaining unsold at the dissolution or civil death of a corporation reverts to the original grantor or his heirs," and as "this time-honored delusion." 3 *Harvard Law Rev.* 135. See *Kales, Future Interests, etc.*, in *Illinois* (2nd Ed.), § 302.

¹⁰¹ *Hastings Corporation v. Letton*, [1908] 1 K. B. 378, 13 Ann. Cas. 574, 3 B. R. C. 617. See note, 8 *Columbia Law Rev.* 410.

¹⁰² *Cumington Realty Associates v. Whitten*, 239 Mass. 313, 132 N. E. 53, 17 A. L. R. 527n; *Capital Garage Co. v. Powell*, 96 Vt. 145, 118 Atl. 524; *Kalkhoff v. Nelson*, 60 Minn. 284, 62 N. W. 332.

¹⁰³ *Bacon v. Robertson*, 18 How. (U. S.) 480, 15 L. Ed. 499; *State v. Commercial State Bank*, 28 Neb. 677, 44 N. W. 998; *People v. O'Brien*, 45 Hun (N. Y.) 519, rev'd 111 N. Y. 1, 18 N. E. 692, 2 L. R. A. 255, 7 Am. St. Rep. 684; *Heath v. Barmore*, 50 N. Y. 302; *Wilson v. Leary*, 120

equitable right of creditors to have the assets applied to the satisfaction of their claims is superior to any rights of the stockholders, or of their assignees. When a corporation is dissolved, its assets are a trust fund for the payment of its debts, and will be applied for this purpose by a court of equity, before any distribution among the stockholders.¹⁰⁴

Rule as to nonstock and charitable corporations.—In a Maine case, the old rule, in so far as personal estate was concerned, was applied to a mutual insurance company, which, after its last policy had expired, voted to discontinue business and wind up its affairs, and obtained a decree of dissolution. As there were no stockholders among whom the assets could be distributed under the statute, it was held that the common-law rule applied, and that the assets vested in the state.¹⁰⁵ The contrary has been held, however, in a Wisconsin case. The mere fact that the corporation has no capital stock does not deprive its members of their proportionate rights in the corporate property.¹⁰⁶

The rule refusing to recognize the claims of individual members has been held to be applicable to eleemosynary, charitable and religious corporations and the like, both as to real and personal estate.¹⁰⁷ Where the purpose is charitable it is said that the choice should be between giving the property back to the donor and administering it *cy pres*, that is as nearly according to the original purpose of the organization as possible. The members have no beneficial or personal interest in the property of a religious or charitable corporation. If the property was sold to the corporation

N. C. 90, 26 S. E. 630, 38 L. R. A. 240, 58 Am. St. Rep. 778; Greenwood v. Union Freight R. Co., 105 U. S. 13, 26 L. Ed. 961; Root v. Wear, 98 Kan. 234, 157 Pac. 1181. See Havemeyer v. Superior Court, 84 Cal. 327, 24 Pac. 121, 10 L. R. A. 627.

¹⁰⁴ Bacon v. Robertson, 18 How. (U. S.) 480, 15 L. Ed. 499; State v. Commercial State Bank, 28 Neb. 677, 44 N. W. 998.

¹⁰⁵ Titcomb v. Kennebunk Mut. Fire Ins. Co., 79 Me. 315, 9 Atl. 732. See Clarke v. Armstrong, 151 Ga. 105, 106 S. E. 289; 35 Harvard Law Rev. 85.

¹⁰⁶ Huber v. Martin, 127 Wis. 412, 105 N. W. 1031, 1135, 3 L. R. A. (N. S.) 653, 115 Am. St. Rep. 1023, 7 Ann. Cas. 400.

¹⁰⁷ Late Corporation of Church of Jesus Christ of Latter-Day Saints v. United States, 136 U. S. 1, 34 L. Ed. 478, 10 Sup. Ct. 792; People v. Trustees of College of California, 38 Cal. 166; Mott v. Danville Seminary, 129 Ill. 403, 21 N. E. 927; Danville Seminary v. Mott, 136 Ill. 289, 28 N. E. 54; People ex rel. v. Greer College, 302 Ill. 538, 135 N. E. 80; Sherman v. Richmond Hose Co., 230 N. Y. 462, 130 N. E. 613; In re Welch Hospital (Netley) Fund, [1921] 1 Ch. 655; Clarke v. Armstrong, 151 Ga. 105, 106 S. E. 289. But compare Hopkins v. Crossley, 138 Mich. 561, 101 N. W. 822 (volunteer fire department; members held to have a pecuniary interest).

the grantor has no more claim to it, and it should go to the state; but land donated to aid a corporation organized for charitable or public purposes will revert to the donor in some cases.¹⁰⁸

When the purpose for which the funds of the corporation were accumulated was not charitable, but yet the funds were not intended merely for the private profit of the members, but to promote some general or public purpose, it may well be contended that there should be a resulting trust in favor of the contributors, if they received no consideration for their contributions. The difficulty is that it is often difficult to find who were the contributors and how much of their donations remain unused. In a South Carolina case the corporation was a social and benevolent organization for the promotion of temperance. It bought and paid for a lot on which it erected a building in which to hold meetings; later it disbanded and the charter expired. It was held that the property did not revert to the original owner or his heirs, but that the members of the society whose contributions had bought the land and improved it were equitably entitled. If there were no creditors or members having any just claim to the land it would escheat to state. There is no reverter of real estate to the grantor.¹⁰⁹

In a late case in the Supreme Court of the United States it was held that, on the repeal by congress of the charter of the Mormon corporation, known as the "Church of Jesus Christ of Latter-Day Saints," chartered by the territory of Utah, all its real estate, which was derived by it from the United States under act of congress, and was held by individuals in trust for the corporation, reverted to the United States, and also that its personal estate escheated to the United States, to be applied either by congress or by the court under the *cy pres* doctrine to some object of a like kind.¹¹⁰ Some recent cases, however, refuse to apply a different rule to charitable

¹⁰⁸ *Clarke v. Armstrong*, 151 Ga. 105, 106 S. E. 289. See *Coe v. Washington Mills Relief Society*, 149 Mass. 543, 21 N. E. 966; 35 Harvard Law Rev. 85; 47 A. L. R. 1336.

¹⁰⁹ *McAlhany v. Murray*, 89 S. C. 440, 71 S. E. 1025, 35 L. R. A. (N. S.) 895, Ann. Cas. 1913 A 1008. See *Franklin County v. Blake*, 283 Ill. 292, 119 N. E. 288; *Neptune Fire Engine & Hose Co. v. Board of Education Mason Co.*, 166 Ky. 1, 178 S. W. 1138, Ann. Cas. 1917 C 789. An incorporated volunteer fire company is not a public charity; upon its dissolution its property goes to its surviv-

ing members, and does not revert to the grantors or go to the state. This rule is applicable to nonstock corporations.

¹¹⁰ *Late Corporation of Church of Jesus Christ of Latter-Day Saints v. United States*, 136 U. S. 1, 47, 34 L. Ed. 478, 10 Sup. Ct. 792.

Where charitable corporation without private founder is dissolved, the sovereign disposes of its property according to its purposes. See notes, Ann. Cas. 1913 A 1013; 35 L. R. A. (N. S.) 895; 47 L. R. A. (N. S.) 1015; *Fletcher, Corporations*, sec. 5594.

corporations than is applied to business corporations and distribute the property to the members at the time of dissolution, although it was never intended for their individual benefit.¹¹¹

§ 268. Effect of dissolution with respect to actions and proceedings.

In the absence of statutory provision to the contrary, a corporation, after it has been legally dissolved, can neither sue nor be sued, and all actions or proceedings commenced against it prior to its dissolution are abated. There are a few decisions to the contrary,¹¹² but this rule is supported by an overwhelming weight of authority.¹¹³ There can be no attachment for debt against a corporation whose charter has expired or been forfeited. And it has also been held that the dissolution of a corporation by expiration of its charter or a decree of forfeiture of its charter rendered pending attachment proceedings against it as defendant, and before judgment therein, dissolves the attachment.¹¹⁴

A judgment rendered against a corporation after its dissolution, though the action may have been brought before, is absolutely void, in the absence of statutory provision to the contrary, just as a judgment rendered against a natural person after his death is void, and it is subject, therefore, to collateral attack.¹¹⁵ And if, after a

¹¹¹ See *Mobile Temperance Hall Ass'n v. Holmes*, 189 Ala. 271, 65 So. 1020 (assets go to surviving members at dissolution); *McAlhany v. Murray*, 89 S. C. 440, 71 S. E. 1025, Ann. Cas. 1913 A 1008, 1012n., 35 L. R. A. (N. S.) 895; *Hopkins v. Crossley*, 138 Mich. 561, 101 N. W. 822; *Victoria Hospital Ass'n v. All Persons*, 169 Cal. 455, 464, 147 Pac. 124.

¹¹² *Kansas City Hotel Co. v. Sauer*, 65 Mo. 279; *Evans v. Interstate Rapid Transit Ry. Co.*, 106 Mo. 594, 17 S. W. 489.

¹¹³ *Mumma v. Potomac Co.*, 8 Pet. (U. S.) 281, 8 L. Ed. 945; *Sturges v. Vanderbilt*, 73 N. Y. 384; *Saltmarsh v. Planters' & Merchants' Bank of Mobile*, 17 Ala. 761; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32; *Life Ass'n of America v. Goode*, 71 Tex. 90; *Combes v. Keyes*, 89 Wis. 297, 62 N. W. 89, 27 L. R. A. 369, 46 Am. St. Rep. 839; *Venable Bros. v. Southern Granite Co.*, 135 Ga. 508, 69 S. E. 822, 32 L. R. A.

(N. S.) 446. See 22 Michigan Law Rev. 161.

¹¹⁴ *Farmers' & Mechanics' Bank v. Little*, 8 Watts & S. (Pa.) 207, 42 Am. Dec. 293; *Wilcox v. Continental Life Ins. Co.*, 56 Conn. 468, 16 Atl. 244; *Stiles v. Laurel Fork Oil & Coal Co.*, 47 W. Va. 838, 35 S. E. 986. Compare *Hays v. Lycoming Fire Ins. Co.*, 99 Pa. St. 621; *Bisbee v. Mt. Battie Mfg. Co.*, 107 Me. 185, 77 Atl. 778.

¹¹⁵ *Crossman v. Vivienda Water Co.*, 150 Cal. 575, 89 Pac. 335; *California Nat. Supply Co. v. Flack*, 183 Cal. 124, 190 Pac. 634; *Dobson v. Simon-ton*, 86 N. C. 492; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32; *Mumma v. Potomac Co.*, 8 Pet. (U. S.) 281, 8 L. Ed. 945; *Merrill v. Suffolk Bank*, 31 Me. 57, 50 Am. Dec. 649; *Venable Bros. v. Southern Granite Co.*, 135 Ga. 508, 69 S. E. 822, 32 L. R. A. (N. S.) 446. See *Trustees of Sea Isle City Realty Co. v. First Nat. Bank of Ocean City*, 87 N. J. Eq. 84, 99 Atl. 929.

judgment is rendered in favor of or against a corporation, the corporation is dissolved by expiration of its charter, or otherwise, no execution on the judgment can be sued out in the name of the corporation, or against it, as the case may be.¹¹⁶

Because of the common-law rule preventing actions by or against a corporation after its dissolution, the only remedy for the protection of the rights of stockholders and creditors was by resort to a court of equity; but in most jurisdictions the difficulty has been obviated by statutory provisions, either continuing the existence of corporations for a certain period after expiration of their charter, for the purpose of allowing them to gradually wind up their affairs, and to sue and be sued, or by making the officers trustees for the creditors and stockholders, and allowing suits by and against them, or by providing for the appointment of a receiver, and allowing suits by and against him.¹¹⁷

¹¹⁶ *May v. State Bank of North Carolina*, 2 Rob. (Va.) 56, 40 Am. Dec. 726; *Allison v. Richardson*, — Tex. Civ. App. —, 171 S. W. 1021.

¹¹⁷ *Havemeyer v. Superior Court*, 84 Cal. 327, 24 Pac. 121, 10 L. R. A.

627; *Crossman v. Vivienda Water Co.*, 150 Cal. 575, 89 Pac. 335. As to these statutes generally, see *Fletcher, Corporations*, secs. 5605, 5620, 5628, 5651; 47 A. L. R. 1397n.

CHAPTER XXI.

LEGISLATIVE CONTROL AND AMENDMENT OF CHARTERS.

§ 269. In general.—The following principles determine the power of the state to control or regulate private corporations, and to repeal, alter or amend their charters:

A charter, when accepted, is a contract between the state and the corporation, within the meaning of the prohibition in the constitution of the United States against the passage by any state of laws impairing the obligations of contracts; and a charter, therefore, cannot be repealed or materially altered at the mere will of the legislature, unless the power to repeal, alter, or amend it has been reserved by the state.

Nor can the legislature pass a law impairing the obligation of contracts between the corporation and its stockholders or members.

Nor can the legislature pass a law impairing the obligation of contracts between a corporation and third persons. But to repeal a charter or authorize it to dissolve does not impair the obligation of the contracts between it and its creditors, unless their remedy against its property is taken away.

The constitutional prohibitions against impairing the obligation of contracts, and against the taking of property without due process of law, do not prevent the state from controlling and regulating corporations, in the exercise of its police power for the public welfare.

§ 270. Constitutional prohibition against laws impairing the obligation of contracts—Dartmouth College case.

The constitution of the United States declares that no state shall pass any "law impairing the obligation of contracts"; and after some difference of opinion, it is now settled beyond any question that when the legislature of a state grants a charter to a *private* corporation, and it is accepted in accordance with its terms by the persons to whom it is granted, the charter involves a *contract* between the state and the corporation, and, in a sense, between the

corporation and its stockholders, within the meaning of this provision. The legislature, therefore, cannot by subsequent legislation repeal or materially change the charter of a private corporation without its consent, unless it has reserved the power to do so in granting the charter, without impairing the obligation of a contract, in violation of the Constitution. A statute having this effect is absolutely void, and cannot in any way affect the rights or powers of the corporation.

Dartmouth College case.—The leading case on this point, known as the “Dartmouth College Case,” was decided by the Supreme Court of the United States in 1819. The case was as follows: In 1769 the King of England granted a charter incorporating “The Trustees of Dartmouth College,” for the purpose of maintaining a college founded and endowed by private individuals, and intrusting its management and control to certain individuals as the first trustees, and to their successors to be chosen by them. The corporation as thus constituted was, by the terms of the charter, to exist “from henceforth and forever,” and was given the capacity to have “perpetual succession and continuance forever.” Afterwards, in 1816, the legislature of New Hampshire passed acts materially amending this charter, increasing the number of trustees, and creating a board of overseers. The corporation, in an action of trover against an officer appointed under the acts, attacked them as void under the constitutional provision above quoted. The state court upheld the acts on the ground that the corporation was a public institution, subject to the control of the legislature, and that the charter was not a contract, within the meaning of the Constitution, and gave judgment for the defendant. On writ of error, the case was argued before the Supreme Court of the United States by most eminent counsel, including Daniel Webster for the plaintiffs in error, and William Wirt for the defendant in error, and was reversed, opinions for reversal being delivered by Chief Justice Marshall and Justices Story and Washington. The court held that the corporation was not public, but private, being founded and endowed by private means; that the charter was a contract, within the meaning of the Constitution; and that the acts of the New Hampshire legislature impaired it, and were void.¹

¹ Trustees of Dartmouth College v. Woodward, 1 N. H. 111, rev'd 4 Wheat. (U. S.) 518, 4 L. Ed. 629. See 1 Rose's notes on United States

Reports, p. 957; Illinois Cent. R. Co. v. Emmerson, 299 Ill. 328, 132 N. E. 471; In re Opinion of the Justices, 237 Mass. 619, 131 N. E. 29. For

"Unexpectedly, this decision extended the protecting arm of the Federal Constitution to corporate charters, stripping the states of the powers to regulate and restrain these creatures of their legislative will." Some doubt has been expressed as to the soundness of this decision, but it has been adhered to by the Supreme Court of the United States in the later cases. It may be argued that a charter is not a contract because it involves no promise or obligation; because there is no valuable consideration; and because it is a mere law or grant of special privilege and not intended as a contract at all. It is also objected that it affords greater protection and superior privileges to corporations than pertain to natural persons, though corporations are more powerful, and deprives the states of their proper authority.²

Provision not applicable to public corporations.—The doctrine that the charter of a corporation is a contract, within the meaning of the constitutional prohibition against laws impairing the obligation of contracts, does not apply to public corporations, such as cities, universities endowed and founded solely by the state, and the like. A public corporation, being created merely as an instrument of government, and not for private ends, is always subject to the control of the legislature. It may be created by the legislature without the consent of the members who compose it, and its charter may be amended or repealed by the legislature at will.³ A corporation, however, is not public, so as to be subject to such control by the legislature, merely because its objects are of a public character. Railroad companies, canal companies, bridge companies, turnpike companies, water and gas companies, and the like, are called *quasi* public corporations, as we have seen, because of the public character of the enterprise; but they are private corporations, and therefore within the protection of the constitutional provision which we are now considering.⁴ The same is true of colleges, universities, libraries, hospitals, and the like, though cre-

criticisms, see *Ashuelot R. R. Co. v. Elliot*, 58 N. H. 451; *Bank of Toledo v. Bond*, 1 Ohio St. 626; 26 Am. Law Rev. 169. See also, "Should the Dartmouth College Case Be Recalled?" 51 Am. Law Rev. 711.

² *Dubuque v. Illinois Cent. R. Co.*, 39 Iowa 56, 95, 96; *Toledo Bank v. Bond*, 1 Ohio St. 622, 630. See 1 *Rose's Notes on United States Reports*, pp. 959-961; 51 A. L. R. 711.

³ *Pawhuska v. Pawhuska Oil & Gas Co.*, 250 U. S. 394, 398, 63 L. Ed. 1054, 1057, 39 Sup. Ct. 526 (as respects grants to municipalities of governmental authority, such as power to regulate rates, the legislative power of the states is not restrained by the contract clause).

⁴ *Greenwood v. Union Freight R. Co.*, 105 U. S. 13, 26 L. Ed. 961.

ated for the purpose of administering a public charity, where they are founded and endowed by private individuals; and it can make no difference that they have also received donations of money or property from the state.⁵

§ 271. What constitutes an impairment of the obligation of the contract with the corporation.

Not only the total repeal of a charter, but any material alteration thereof, impairs the obligation of the contract created by the grant of a charter. In the Dartmouth College Case, hereinbefore referred to, the charter of the college was not totally repealed, but merely amended. The amendment, however, changed the name of the corporation from "The Trustees of Dartmouth College" to "The Trustees of Dartmouth University"; increased the number of trustees from twelve, the number fixed by the charter, to twenty-one, nine of whom to constitute a quorum; allowed the governor of the state and council to appoint the nine additional members, whereas the charter allowed the twelve trustees to choose their successors; empowered the trustees to organize colleges in the university, establish an institute, and elect fellows and members thereof; and created a board of overseers, twenty-five in number, to be appointed by the governor and council, with power to disapprove and negative votes of the trustees relative to the appointment and removal of the president, professors, and other officers, to salaries, and to the establishment of colleges and professorships, and the erection of new college buildings, whereas the whole management and control of such matters was vested by the charter in the twelve trustees. It was held that the alterations were material, and such as to impair the charter.⁶

§ 272. Impairment of contract between the corporation and its stockholders or members.

When persons become stockholders or members of a corporation, either at the time of its creation or afterwards, there is a contract between them and the corporation, and these contracts are just as much within the protection of the constitutional prohibition against laws impairing the obligation of contracts as the contract between

⁵ Trustees of Dartmouth College v. Woodward, 4 Wheat. (U. S.) 518, 4 L. Ed. 629; Cary Library v. Bliss, 151 Mass. 364, 25 N. E. 92, 7 L. R. A. 765. See also, Downing v. Indiana State Board of Agriculture, 129

Ind. 443, 28 N. E. 123, 614, 12 L. R. A. 664.

⁶ Trustees of Dartmouth College v. Woodward, 4 Wheat. (U. S.) 518, 4 L. Ed. 629; 40 Harvard Law Rev. 891.

the state and the corporation. The state, therefore, cannot pass any law which impairs the obligation of such contracts, unless it has reserved the power to alter, amend, or repeal the charter, and the law is within such reserved power. For example, it has been held that the state cannot by statute passed after the creation of a corporation, authorize a majority of the stockholders to accept an amendment of its charter, against the dissent of the minority, and engage thereunder in a business or transaction which is not authorized by the original charter.⁷ The principle also applies to a statute amending the charter of a corporation so as to allow consolidation with other corporations;⁸ or, by the weight of authority, so as to allow cumulative voting at stockholders' meetings, or otherwise change the number of votes of stockholders, or method of voting, fixed by the charter;⁹ or to directly or indirectly increase the liability of stockholders to the creditors of the corporation.¹⁰

§ 273. Impairment of contracts between the corporation and third persons.

A law may also be unconstitutional as impairing the obligation of contracts between the corporation and third persons or other corporations. The legislature cannot constitutionally pass any law which will destroy or impair the vested rights of a corporation under a contract between it and a municipal corporation, or between it and any other corporation or person, authorized, expressly or impliedly, by its charter. Thus, a valid contract between a street-railroad company and a city by which the company is given a franchise to construct and operate a street-railroad system on the streets of the city cannot be impaired by subsequent legislation.¹¹

⁷ *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617; *Allen v. Francisco Sugar Co.*, 92 N. J. Eq. 391, 110 Atl. 37; *Stevens v. Rutland & B. R. Co.*, 29 Vt. 545; *Dow v. Northern Railroad*, 67 N. H. 1, 36 Atl. 510; *New Orleans J. & G. N. R. Co. v. Harris*, 27 Miss. 517. Compare ante, § 175.

⁸ *Lauman v. Lebanon Val. R. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; *Colgate v. United States Leather Co.*, 75 N. J. Eq. 229, 72 Atl. 126, 19 Ann. Cas. 1262, 1266n. Necessity of assent of all stockholders to consolidation of corporations.

⁹ *State v. Greer*, 78 Mo. 188; *Hays v. Commonwealth*, 82 Pa. St. 518; *Tucker v. Russell*, 82 Fed. 263; *In re Newark Library Ass'n*, 64 N. J.

Law 217, 43 Atl. 455. Compare *New Haven & D. R. Co. v. Chapman*, 38 Conn. 56. See *Lord v. Equitable Life Assur' Soc.*, 194 N. Y. 212, 87 N. E. 443, 22 L. R. A. (N. S.) 420n; *Looker v. Maynard*, 179 U. S. 46, 45 L. Ed. 79, 21 Sup. Ct. 21.

¹⁰ *Ireland v. Palestine, B., N. P. & N. W. Turnpike Co.*, 19 Ohio St. 369; *Evans v. Nellis*, 101 Fed. 920; *Yoncalla State Bank v. Gemmill*, 134 Minn. 336, 159 N. W. 798, L. R. A. 1917 A 1223; *First Nat. Bank v. Multnomah State Bank*, 87 Ore. 423, 170 Pac. 534. See *Duke v. Force*, 120 Wash. 599, 208 Pac. 67.

¹¹ *Los Angeles v. Los Angeles City Water Co.*, 177 U. S. 558, 44 L. Ed. 886, 20 Sup. Ct. 736; *Minneapolis v. Minneapolis St. Ry. Co.*, 215 U. S.

The legislature cannot pass a valid law destroying or impairing the vested rights of creditors of a corporation.¹² Thus, it cannot, as to existing creditors, impair the statutory liability of stockholders. The effect of statutes which obligate the stockholders of a corporation to pay its indebtedness to an amount equal to the stock owned by them, and which authorize the institution and maintenance of proceedings by the creditors to enforce the liability, is to make the relation between the creditors and the stockholders contractual in its nature; and, being contractual, the relation is within the protection of the prohibition against laws impairing the obligation of contracts.¹³

The constitutional prohibition against laws impairing the obligation of contracts does not prevent the legislature from repealing the charter of a corporation at any time with the consent of all the stockholders or members, or without their consent, where the charter reserves such power, or from conferring upon them authority to dissolve before the expiration of their charter; for, in the first place, the obligation of the contracts between a corporation and its creditors survives the dissolution of the corporation, and the creditors may enforce their claims against its property, and, in the second place, persons contracting with the corporation are presumed to know that a corporation, by the very terms and nature of its existence, is subject to dissolution, either by the surrender of its charter and acceptance of the surrender by the state, or by a forfeiture of its charter for misuser or nonuser.¹⁴ But the legislature

417, 54 L. Ed. 259, 30 Sup. Ct. 118; *City Ry. Co. v. Citizens' St. R. Co. (Ind.)*, 52 N. E. 157.

A statute providing that suicide shall not be a defense to an action on any life insurance policy impairs the obligation of contracts as to all policies, containing a provision to the contrary, issued before the passage of the act. *Jarman v. Knights Templars' & Masons' Life Indemnity Co.*, 95 Fed. 70; *Superior Water, Light & Power Co. v. City of Superior*, 263 U. S. 125, 137, 68 L. Ed. 204, 44 Sup. Ct. 82. A power reserved by statute to alter, amend or repeal charters will not be applicable to property rights of a corporation acquired by contract with a city, such as the exclusive right to maintain and operate a water works for a specified period; such contract rights are not subject to impairment by being changed into an

indeterminate permit, and such rights are not part of the grant or charter of incorporation.

¹² *Hawthorn v. Calef*, 2 Wall. (U. S.) 10, 17 L. Ed. 776; *People v. O'Brien*, 45 Hun (N. Y.) 519, rev'd 111 N. Y. 1, 18 N. E. 692, 2 L. R. A. 255, 7 Am. St. Rep. 684. See *Mumma v. Potomac Co.*, 8 Pet. (U. S.) 281, 8 L. Ed. 945; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32.

¹³ *Hawthorn v. Calef*, 2 Wall. (U. S.) 10, 17 L. Ed. 776; *Adler v. Baker-Dodge Theatre Co.*, 190 Iowa 970, 181 N. W. 254. It is otherwise if the liability is penal.

¹⁴ Constitutionality of dissolution, see *Mumma v. Potomac Co.*, 8 Pet. (U. S.) 281, 8 L. Ed. 945; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32; *Bacon v. Robertson*, 18 How. (U. S.) 480, 15 L. Ed. 499; *Foster v. Essex Bank*, 16 Mass. 245,

cannot deprive the creditors of a corporation of their right to resort, in equity or otherwise, to the property of the corporation for the satisfaction of their claims.¹⁵

§ 274. Legislation changing or affecting remedies.

The constitutional prohibition against laws impairing the obligation of contracts does not apply, as a rule, to laws which merely affect the remedy.¹⁶ If the period of existence of a corporation is limited by its charter, and the legislature has not reserved any right to alter or amend the charter, it is clear that it cannot constitutionally extend the period of its existence, without its consent and the consent of all the stockholders, for the purpose of continuance of its business beyond the period limited.¹⁷ But after a corporation has been created for a limited time, the legislature may constitutionally continue its existence for a certain period for the purpose, not of continuing its business, but of prosecuting and defending suits, and of enabling it to gradually settle and wind up its affairs and distribute its assets. Such a statute does not impair any rights, either of the corporation, or of its stockholders, or of its creditors, but merely provides a remedy for the enforcement of rights which, in the absence of any statute, would be recognized and enforced in equity, creditors of a dissolved corporation having the right in equity to have their claims paid out of the assets of the corporation before any distribution of the same among the stockholders.¹⁸

§ 275. Consent of the corporation and its members.

The constitutional prohibition against laws impairing the obligation of contracts does not prevent the legislature from amending the charter of a corporation with its consent,—with the consent of all the corporators, or with the consent of a majority, where the

8 Am. Dec. 135; *Read v. Frankfort Bank*, 23 Me. 318; *Curran v. Arkansas*, 15 How. (U. S.) 304, 310, 14 L. Ed. 705; *Crossman v. Vivienda Water Co.*, 150 Cal. 575, 89 Pac. 335.

¹⁵ *People v. O'Brien*, 45 Hun (N. Y.) 519, rev'd 111 N. Y. 1, 18 N. E. 692, 2 L. R. A. 255, 7 Am. St. Rep. 684.

¹⁶ *Bank of Columbia v. Okely*, 4 Wheat. (U. S.) 235, 4 L. Ed. 559.

¹⁷ The privilege of renewal or extension of corporate existence may be

exercised by a majority of stockholders. The rule that fundamental changes require unanimous consent does not apply to changes authorized by the charter or by statutes in force at the time of incorporation. *McKemie v. Eady-Baker Grocery Co.*, 146 Ga. 753, 92 S. E. 282.

¹⁸ *Foster v. Essex Bank*, 16 Mass. 245, 8 Am. Dec. 135; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32.

amendment is one which the majority may accept against the dissent of the minority, as elsewhere explained,—or from authorizing the incorporators to amend.¹⁹ A majority of the stockholders of a corporation cannot bind a dissenting minority—at least, where the legislature has not reserved the power to amend the charter—by accepting an amendment which fundamentally changes the character or objects of the corporation.²⁰ But a majority may accept an amendment which makes no such change, but is merely in furtherance of the objects for which the corporation was created.²¹

§ 276. Exercise of the police power of the state.

The constitutional prohibition against the passage of laws by a state impairing the obligation of contracts does not exempt corporations from the police power of the state. With respect to this power, corporations are in substantially the same position as natural persons. The constitution prevents the legislature from depriving a corporation of powers which are secured to it by its contract with the state,—that is, by its charter,—but it does not prevent the legislature from controlling a corporation, and regulating its conduct, just as it may control and regulate the conduct of a natural person, in the exercise of the police power of the state, in so far as it may be necessary to do so in the interest of the public safety, health, property, comfort, or morals.²² The distinction between the powers which the legislature may exercise under an express reservation in the charter of the power to amend and those which may be exercised under the general regulatory or police power where there is no reservation is not very clearly drawn.^{22a}

¹⁹ *Jackson v. Walsh*, 75 Md. 304, 23 Atl. 778; *Phinney v. Trustees of Sheppard & Enoch Pratt Hospital*, 88 Md. 633, 42 Atl. 58; *State ex rel. Perkins v. Montgomery Light Co.*, 102 Ala. 594, 15 So. 347; *Pennsylvania R. Co. v. Duncan*, 111 Pa. St. 352, 5 Atl. 742.

²⁰ *Stevens v. Rutland & B. R. Co.*, 29 Vt. 545. See note Ann. Cas. 1912 C 1203, Right of majority of stockholders to accept amendment to charter against will of minority. And see post, § 282.

²¹ *Ireland v. Palestine, B., N. P. & N. W. Turnpike Co.*, 19 Ohio St. 369 ("The power of a majority of the members to accept an amendment of the charter so as to bind the mi-

nority is confined to such modifications as are reasonably within the original objects of the incorporation"); *Reid v. Eatonton Mfg. Co.*, 40 Ga. 98, 2 Am. Rep. 563. Compare post, § 282. Cp. also, *Allen v. Scott*, 104 Ohio St. 436, 135 N. E. 683; *Somerville v. St. Louis Min. & Mill. Co.*, 46 Mont. 268, 127 Pac. 464, L. R. A. 1915 B 811n; *Perkins v. Coffin*, 84 Conn. 275, 79 Atl. 1070, Ann. Cas. 1912 C 1188.

²² *Boston Beer Co. v. Massachusetts*, 97 U. S. 25, 24 L. Ed. 989; *Eagle Ins. Co. v. Ohio*, 153 U. S. 446, 14 Sup. Ct. 863, 38 L. Ed. 778.

^{22a} See *Venner v. Chicago City R. Co.*, 246 Ill. 170, 92 N. E. 643, 138 Am. St. Rep. 229, 20 Ann. Cas. 607.

In a leading case in the Supreme Court of the United States it was held that an act of the legislature prohibiting generally the sale of intoxicating liquors was not unconstitutional as applied to a private corporation which had been chartered prior to the passage of the act, and which was expressly authorized by its charter to manufacture malt liquors of all kinds, and impliedly authorized to sell the same.²³ The granting of corporate capacity to manufacture and sell liquor was not intended to confer any greater privilege on the corporation than any citizen already had, nor was it intended to exempt the corporation from legislative control of its business. The legislature could not by contract divest itself of the police or regulatory power if it had intended to agree to do so.

It is well settled that the police power of the state extends to the reasonable regulation and limitation of the rates that may be charged by *quasi* public corporations like railroad companies, canal companies, water and gas companies, and the like,²⁴ and by other corporations whose business is in the nature of a public employment, so as to affect the public generally, as in the case of warehouse companies.²⁵

The obligation may be imposed upon street car companies to carry free city detectives engaged in the discharge of their duties, and this burden may be justified either as a valid exercise of the reserved power to amend the company's charter, or as not being an arbitrary or unreasonable exercise of the police powers.²⁶ The power of the legislature to require corporations to pay their employees weekly or semimonthly instead of monthly, or otherwise to limit or regulate their rights to contract for the public welfare has been sustained on the reserved power to amend charters.^{26a} It would seem that this is a very artificial ground and that the true basis is an exercise of the police power.

²³ *Boston Beer Co. v. Massachusetts*, 97 U. S. 25, 24 L. Ed. 989.

²⁴ *Chicago, B. & Q. R. Co. v. Iowa*, 94 U. S. 155, 24 L. Ed. 94; *Smyth v. Ames*, 169 U. S. 466, 42 L. Ed. 819, 18 Sup. Ct. 418; *Lake Shore & M. S. Ry. Co. v. Smith*, 173 U. S. 684, 43 L. Ed. 858, 19 Sup. Ct. 565; *City of Cleveland v. Public Utilities Comm.*, 102 Ohio St. 341, 131 N. E. 714; *Fletcher, Corporations*, sec. 4376.

²⁵ *Munn v. Illinois*, 94 U. S. 113, 24 L. Ed. 77.

²⁶ *Sutton v. New Jersey*, 244 U. S. 258, 61 L. Ed. 1117, 37 Sup. Ct. 508.

Compare *Napier v. Delaware, L. & W. R. Co.*, 91 N. J. Law 282, 102 Atl. 444.

^{26a} *Arkansas Stave Co. v. Arkansas*, 94 Ark. 27, 125 S. W. 1001, 27 L. R. A. (N. S.) 255, 140 Am. St. Rep. 103; *Leep v. St. Louis, I. M. & S. Ry. Co.*, 58 Ark. 407, 25 S. W. 75, 23 L. R. A. 264, 41 Am. St. Rep. 109; *Lawrence v. Rutland R. Co.*, 80 Vt. 370, 67 Atl. 1091, 15 L. R. A. (N. S.) 350, 13 Ann. Cas. 475; *New York Cent. & H. R. R. Co. v. Williams*, 199 N. Y. 108, 92 N. E. 404, 35 L. R. A. (N. S.) 549, 139 Am. St. Rep. 850.

§ 277. Reservation by state of power to alter, amend, or repeal charters.

In the *Dartmouth College* case, Mr. Justice Story suggested that the state might, in granting a charter, reserve the power to amend or repeal the same, and since the decision in that case this has very generally been done. In the case of special charters the power to amend or repeal has generally been reserved in the charter itself. General laws have also been enacted in most states, if not in all, containing such a reservation, and they apply to all corporations afterwards organized, unless expressly excepted.²⁷ In some states the people have not left the matter to the legislature, but have themselves adopted a constitutional provision reserving such power. Of course, neither a statute nor a constitutional provision reserving the power to amend or repeal charters can give the power to amend or repeal the charter of a corporation created or organized before its enactment or adoption without the reservation of such power.²⁸ When corporations are consolidated, and a new corporation is created as of the time of the consolidation, this new corporation is subject to a statutory or constitutional reservation of the power to amend or repeal charters then in force, though there may have been no such power as to the original corporations.²⁹

§ 278. Extent of reserved power to repeal.

When the charter of a corporation, or a general law or constitutional provision, reserves to the legislature the right to alter, amend, or repeal a charter at will or at pleasure, the power to repeal is absolute, and the courts cannot inquire into the legislature's motive in exercising it.³⁰ If the reservation is of the power

²⁷ Such a reservation becomes a term of the charter of corporations afterwards created or organized, without any express reference to the general law. *Greenwood v. Union Freight R. Co.*, 105 U. S. 13, 26 L. Ed. 961; *Commonwealth v. Eastern R. Co.*, 103 Mass. 254, 4 Am. Rep. 555; *Tomlinson v. Jessup*, 15 Wall. (U. S.) 454, 21 L. Ed. 204; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32; *Randle v. Winona Coal Co.*, 206 Ala. 254, 89 So. 790, 19 A. L. R. 118.

²⁸ *Dodge v. Woolsey*, 18 How. (U. S.) 331, 15 L. Ed. 401; *New Orleans Gas-Light Co. v. Louisiana Light & Heat Producing & Mfg. Co.*, 115 U. S. 660, 29 L. Ed. 516, 6 Sup. Ct. 252.

²⁹ *Shields v. Ohio*, 95 U. S. 319, 24 L. Ed. 357; *Atlantic & Gulf R. Co. v. Georgia*, 98 U. S. 359, 25 L. Ed. 185. The consolidated corporation is subject to the reserved power to alter, amend and repeal provided by law at the time of consolidation, although the constituent corporations each had qualified exemptions from taxation under irrepealable charters. Their immunity did not pass to the new corporation. See 89 Am. St. Rep. 608n; 8 Fletcher, Corporations, sec. 5444.

³⁰ *Calder v. Michigan*, 218 U. S. 591, 54 L. Ed. 1163, 31 Sup. Ct. 122; *People ex rel. Ellis v. Calder*, 153 Mich. 724, 117 N. W. 314, 126 Am.

to repeal on the happening of certain conditions, as, for example, violation of its charter or other default by the corporation, the power to repeal is not absolute, but depends upon the happening of such conditions. When such conditions happen the power is absolute.³¹

§ 279. **Extent of reserved power to amend.**—The state may, in granting a charter, reserve the power to repeal, alter, or amend the same at will, either in a special charter, or in a general law, or in the state constitution; and such a reservation will constitute a term of the contract between the corporation and the state.

- (a) Such a reservation does not authorize arbitrary, unreasonable, and oppressive amendments.
- (b) Nor does it authorize amendments changing the fundamental character of the corporation, or empowering it to engage in an entirely different enterprise or business from that contemplated by its charter.
- (c) Nor does it authorize alterations or amendments depriving a corporation, or its stockholders or creditors, of vested rights of property without due process of law.

Fundamental amendments, to be binding upon the corporation and its stockholders, must be expressly or impliedly accepted or authorized by the charter or law in force at the time of incorporation.

The extent of the power to alter or amend the charter of a corporation, instead of repealing it, under a reservation of the power to alter, amend, or repeal at the pleasure of the legislature, has been the subject of much diversity of opinion. It is settled that the power is not unlimited, but it is very difficult to say what its limits are. The following general rules may be fairly deduced from the decisions:

(1) Such a reservation, at the least, gives the legislature the power to make any alteration or amendment in a charter which will not defeat or substantially impair the object of the grant, or rights of property which have vested under it, and which the legislature may deem necessary to secure either that object or any

St. Rep. 550; *Greenwood v. Union Freight R. Co.*, 105 U. S. 13, 26 L. Ed. 961; *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32; *Read v. Frankfort Bank*, 23 Me. 318.

³¹ *Commonwealth v. Bonsall*, 3

Whart. (Pa.) 559; *Erie & N. E. R. Co. v. Casey*, 1 Grant Cas. (Pa.) 274, 26 Pa. St. 287; *Flint & F. Plank Road Co. v. Woodhull*, 25 Mich. 99, 12 Am. Rep. 233. See *State v. Noyes*, 47 Me. 189.

other public or private rights.³² The power, it has been said, may be exercised in all cases and to any extent to carry out the original purposes of the incorporation, and to secure the due administration of justice in regard to the rights of the creditors of the corporation and the proper disposition of its assets.³³ It may be exercised by conferring upon a corporation additional powers which are merely auxiliary to the object for which the corporation was originally created.³⁴

(2) As is stated above, however, the reserved power of the legislature to alter or amend the charter of a corporation is not unlimited, even where the power to alter, amend, or repeal at its will or pleasure is reserved. Such a reservation does not authorize arbitrary and unreasonable amendments.³⁵ Nor, as we shall see, does it authorize alterations or amendments which will defeat, change, or substantially impair the object of the incorporation, or change its fundamental character.³⁶ Nor does it authorize alterations or amendments depriving a corporation, or its stockholders or creditors, of vested rights of property without due process of law.³⁷ It is the contract inhering in the charter as distinguished from contracts and property acquired under the charter, which is subject to the state's reserved power to amend or repeal. "The power of alteration and amendment," said Mr. Justice Swayne in the Supreme Court of the United States, "is not without limit.

³² Commissioners of Inland Fisheries v. Holyoke Water Power Co., 104 Mass. 446, 6 Am. Rep. 247, aff'd 15 Wall. (U. S.) 500, 21 L. Ed. 133; Macon & B. R. Co. v. Gibson, 85 Ga. 1, 11 S. E. 442, 21 Am. St. Rep. 135; Leep v. St. Louis, I. M. & S. Ry. Co., 58 Ark. 407, 25 S. W. 75, 23 L. R. A. 264, 41 Am. St. Rep. 109; Watts v. Lenoir & Blowing Rock Turnpike Co., 181 N. C. 129, 106 S. E. 497.

³³ Union Pac. R. Co. v. United States (Sinking-Fund Cases), 99 U. S. 700, 25 L. Ed. 496; New York & N. E. R. Co. v. Town of Bristol, 151 U. S. 556, 38 L. Ed. 269, 14 Sup. Ct. 437, aff'g 62 Conn. 257, 26 Atl. 122; Park v. Modern Woodmen of America, 181 Ill. 214, 54 N. E. 932; Read v. Frankfort Bank, 23 Me. 318.

³⁴ Buffalo & N. Y. C. R. Co. v. Dudley, 14 N. Y. 336; Durfee v. Old Colony & Fall River R. Co., 5 Allen (Mass.) 230.

³⁵ Chicago, M. & St. P. R. Co. v. Wisconsin, 238 U. S. 491, 59 L. Ed.

1423, 35 Sup. Ct. 869, L. R. A. 1916 A 1133; Shields v. Ohio, 95 U. S. 319, 24 L. Ed. 357. See note 7 Columbia Law Rev. 598, Limitations on the reserved right to amend or repeal corporate charters; Dodd, 75 Uni. Pa. Law Rev. 585; Stern, 53 American Law Register (44 N. S.) 1.

³⁶ Shields v. Ohio, 95 U. S. 319, 24 L. Ed. 357; Zabriskie v. Hackensack & N. Y. R. Co., 18 N. J. Eq. 178, 90 Am. Dec. 617; Buffalo & N. Y. C. R. Co. v. Dudley, 14 N. Y. 336. See People v. Beakes Dairy Co., 222 N. Y. 416, 119 N. E. 115, 3 A. L. R. 1260.

³⁷ Superior Water, Light & Power Co. v. City of Superior, 263 U. S. 125, 137, 68 L. Ed. 204, 44 Sup. Ct. 82; Shields v. Ohio, 95 U. S. 319, 24 L. Ed. 357; Commonwealth v. Essex Co., 13 Gray (Mass.) 239; City of Detroit v. Detroit & Howell Plank Road Co., 43 Mich. 140, 5 N. E. 275; Watts v. Lenoir & Blowing Rock Turnpike Co., 181 N. C. 129, 106 S. E. 497.

The alterations must be reasonable; they must be made in good faith, and be consistent with the scope and object of the act of incorporation. Sheer oppression and wrong cannot be inflicted under the guise of amendment or alteration. Beyond the sphere of the reserved powers, the vested rights of property of corporations, in such cases, are surrounded by the same sanctions and are as inviolable as in other cases."³⁸

Particular alterations or amendments.—A water-power company or other corporation, authorized by its charter to construct and maintain a dam across a river or stream in which migratory fish are accustomed to pass, may be required to construct suitable fishways at its own expense, if the power to alter or amend its charter has been reserved,³⁹ unless a right to maintain fishways as already constructed has become a vested right of property by reason of payment of damages, under legislative authority, to persons owning rights of fishery;⁴⁰ and a corporation authorized to construct and maintain a dam across a navigable stream may be required to construct a suitable lock for the passage of vessels.⁴¹

If the charter of Dartmouth College had reserved the power to alter or amend the same, there can be no doubt that the amendatory acts of the legislature of New Hampshire would have been upheld in so far as they increased the number of trustees, and provided for the appointment of the additional trustees by the executive of the state.⁴² Since that decision it has been expressly held that, under such a reservation of power, the legislature might increase the number of trustees of a college in which the state was interested, and require that a majority of them should consist of officers of the state.⁴³

Under a reservation of power to alter or amend the charter of a corporation, it has been held that the legislature may authorize an increase or reduction of the amount of its capital stock, provided no vested rights of property are impaired.⁴⁴ And it may change

³⁸ *Shields v. Ohio*, 95 U. S. 319, 24 L. Ed. 357.

³⁹ *Commonwealth v. Essex Co.*, 13 Gray (Mass.) 239; *Commissioners of Inland Fisheries v. Holyoke Water Power Co.*, 104 Mass. 446, 6 Am. Rep. 247.

⁴⁰ *Commonwealth v. Essex Co.*, 13 Gray (Mass.) 239. See post, § 280.

⁴¹ *South Bay Meadow Dam Co. v. Gray*, 30 Me. 547.

⁴² Ante, § 272. See 40 *Harvard Law Rev.* 891.

⁴³ *Jackson v. Walsh*, 75 Md. 304, 23 Atl. 778.

⁴⁴ *Buffalo & N. Y. C. R. Co. v. Dudley*, 14 N. Y. 336; *Durfee v. Old Colony & Fall River R. Co.*, 5 Allen (Mass.) 230. Compare, however, *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617.

the number or mode of voting at stockholders' meetings, so as allow cumulative voting.⁴⁵ A charter of an insurance company, may be amended so as to permit policyholders, or those carrying a prescribed amount of insurance, to vote for all or a less number of directors, where the old charter permitted mutualization. The amendment simply allowed the object contemplated by the charter to be effected by a method varying in unessential details from that provided by the old charter itself. It was never contemplated that the stockholders should be entitled to the perpetual control of the company.^{45a} An amendment may make stockholders of existing corporations individually liable for debts of the corporation subsequently contracted.⁴⁶ And a railroad company's charter may be so far amended as to require it to provide a sinking fund for the protection of holders of its bonds or other obligations.⁴⁷

When the legislature has reserved the power to alter, amend, or repeal the charter of a railroad company, it may, for the safety and convenience of the public or the security of property, make different regulations as to the construction and operation of its road than those contained in its charter. Thus, the company may be required to establish stations at other places than were contemplated by its charter, to change the grade of its road, to construct and maintain bridges, gates, or other safeguards at highway crossings, to fence its tracks, or to construct and maintain cattle guards, etc.⁴⁸ It may impose on a street railway corporation the obligation

⁴⁵ *Looker v. Maynard*, 179 U. S. 46, 45 L. Ed. 79, 21 Sup. Ct. 21, aff'g Attorney General ex rel. Dusenbury v. Looker, 111 Mich. 498, 69 N. W. 929, 56 L. R. A. 947; *Cross v. West Virginia Cent. & Pittsburg Ry. Co.*, 35 W. Va. 174, 12 S. E. 1071. Contra, *Hays v. Commonwealth*, 82 Pa. St. 518; *Gregg v. Granby Mining & Smelting Co.*, 164 Mo. 616, 65 S. W. 312. See *Lord v. Equitable Life Ass'n Soc. of United States*, 194 N. Y. 212, 87 N. E. 443, 22 L. R. A. (N. S.) 420.

^{45a} *Lord v. Equitable Life Assur. Soc. of United States*, 194 N. Y. 212, 87 N. E. 443, 22 L. R. A. (N. S.) 420. See 17 Green Bag 353.

⁴⁶ *Sherman v. Smith*, 1 Black (U. S.) 587, 17 L. Ed. 163; *Gardner v. Hope Ins. Co.*, 9 R. I. 194, 11 Am. Rep. 238; *In re Lee's Bank*, 21 N. Y. 9; *Somerville v. St. Louis Min. & Mill. Co.*, 46 Mont. 268, 127 Pac. 464, L. R. A. 1915 B 811n; *Duke v. Force*,

120 Wash. 599, 208 Pac. 67, 23 A. L. R. 1354; *Williams v. Nall*, 108 Ky. 21, 55 S. W. 706; *Allen v. Scott*, 104 Ohio St. 436, 135 N. E. 683; *Maxwell v. Thompson*, 195 N. Y. App. Div. 616, 186 N. Y. Supp. 208. But see *Garey v. St. Joe Min. Co.*, 32 Utah 497, 91 Pac. 369, 12 L. R. A. (N. S.) 554; note, 7 Columbia Law Rev. 598.

⁴⁷ *Union Pac. R. Co. v. United States (Sinking-Fund Cases)*, 99 U. S. 700, 25 L. Ed. 496.

⁴⁸ *New York & N. E. R. Co. v. Town of Bristol*, 151 U. S. 556, 38 L. Ed. 269, 14 Sup. Ct. 437, aff'g 62 Conn. 257; *Commonwealth v. Eastern R. Co.*, 103 Mass. 254, 4 Am. Rep. 555; *Fitchburg R. Co. v. Grand Junction Railroad & Depot Co.*, 4 Allen (Mass.) 198, 205.

Indeed, as we have seen, without any reservation of power to alter or amend, such regulations as these might be made in the exercise of the

to carry free city detectives engaged in the discharge of their duties, either as an amendment of their charters or as a valid exercise of the police power.^{48a}

Where the charter of a railroad company, or the general law, reserves the right to alter or amend the same, the legislature may take away from the company a general power given by its charter to consolidate with other corporations, so long as the power is unexecuted, to such an extent as to prohibit consolidation with parallel or competing lines.⁴⁹

In *Berea College v. Kentucky*,^{49a} a statute provided that, "it shall be unlawful for any person, corporation, or association of persons to maintain or operate any college, school, or institution" where both whites and negroes were taught. It was held that the fact that corporations were separately mentioned in the act justified the inference that the statute was separable, and was to be so construed as to be upheld as to corporations under the reserved power to amend corporate charters. It substantially declares that any authority given by the previous charter to instruct the two races at the same time and place is forbidden.

§ 280. Impairment of vested rights.

A reservation of the power to alter, amend, or repeal the charter of a corporation gives the legislature no right to take away or impair the vested rights of property of the corporation, without making due compensation. "Beyond the sphere of the reserved powers, the vested rights of property of corporations, in such cases, are surrounded by the same sanctions and are as inviolable as in other cases."⁵⁰ Nor does it give the legislature the power to impair the vested property rights of the stockholders or creditors of the corporation.⁵¹ This principle is well illustrated by a Massa-

police power of the state. See ante, § 277.

^{48a} *Sutton v. New Jersey*, 244 U. S. 258, 61 L. Ed. 1117, 37 Sup. Ct. 508. See also, *International Bridge Co. v. New York*, 254 U. S. 126, 65 L. Ed. 176, 41 Sup. Ct. 56.

⁴⁹ *Pearsall v. Great Northern Ry. Co.*, 161 U. S. 646, 40 L. Ed. 838, 16 Sup. Ct. 705.

^{49a} 211 U. S. 45, 53 L. Ed. 81, 29 Sup. Ct. 33.

Even if the statute should be deemed unconstitutional so far as natural persons are concerned, the pro-

vision relating to them is separable from that relating to corporations, and upheld as to them. See 22 *Harvard Law Rev.* 217.

⁵⁰ *Shields v. Ohio*, 95 U. S. 319, 24 L. Ed. 357. And see *Commonwealth v. Essex Co.*, 13 *Gray (Mass.)* 239; *City of Detroit v. Detroit & Howell Plank-Road Co.*, 43 *Mich.* 140, 5 N. E. 275; *Ashuelot R. R. v. Elliot*, 52 N. H. 387; s. c., 58 N. H. 451.

⁵¹ *People v. O'Brien*, 45 *Hun* 519, rev'd 111 N. Y. 1, 18 N. E. 692, 2 L. R. A. 255, 7 *Am. St. Rep.* 684.

chusetts case. It has been held in that state, as we have seen, that a water-power company, authorized by its charter to construct and maintain a dam across a river or stream in which migratory fish are accustomed to pass, may, under a reservation of power to alter or amend its charter, be required to construct and maintain suitable fishways, unless it has acquired a vested right to maintain fishways as already constructed by it.⁵²

But where such a corporation had already built fishways, though insufficient ones, and the legislature afterwards, with knowledge that they were insufficient, amended the charter of the corporation by authorizing it to increase its capital stock, upon the express condition that it should be liable for all damages occasioned to the owners of fish rights by the stopping or impeding of the passage of fish by its dam, the damages to be assessed as provided in the act, and the damages were afterwards assessed, and paid by the corporation, it was held that the corporation thereby acquired a vested right to maintain the dam as then constructed, and that the legislature could not afterwards require it to construct and maintain other fishways at its own expense.⁵³ A reservation of the power to repeal the charter of a railroad company gives the legislature the power to repeal the charter and thereby dissolve the corporation, but it gives it no power to deprive the stockholders of the property rights acquired in pursuance of the charter, or to impair the obligation of contracts made by the corporation with a third person under the power conferred by the charter.⁵⁴

§ 281. Acceptance of amendments.

The fact that the legislature has reserved the power to amend the charter of a corporation does not give it the power to compel the corporation to continue business under the amended charter, whether the corporators are willing to do so or not. The corporation is not bound by the amended charter unless it expressly or impliedly accepts the same; but it has no right to continue under its original charter, and, if it does continue its business, it thereby impliedly accepts the amendment, and is bound thereby.⁵⁵ Amend-

⁵² Commissioners of Inland Fisheries v. Holyoke Water Power Co., 104 Mass. 446, 6 Am. Rep. 247.

⁵³ Commonwealth v. Essex Co., 13 Gray (Mass.) 239.

⁵⁴ People v. O'Brien, 45 Hun 519, rev'd 111 N. Y. 1, 18 N. E. 692, 2 L. R. A. 255, 7 Am. St. Rep. 684.

⁵⁵ Yeaton v. Bank of Old Dominion, 21 Grat. (Va.) 593. See Chicago, M. & St. P. Ry. Co. v. Des Moines Union R. Co., 254 U. S. 196, 65 L. Ed. 219, 41 Sup. Ct. 81, rev'g 254 Fed. 927.

ments conferring additional power upon a corporation, as the power of eminent domain, for example, and not changing the object or character of a corporation, may be accepted by the board of directors, where the power conferred is one which could be exercised by them if it had been originally granted. Other amendments must be accepted by the stockholders.⁵⁶

Whether amendments can be accepted by a majority of the stockholders, so as to bind the dissenting minority, depends upon the character of the amendment. The decisions on the question are conflicting.⁵⁷ Unless authorized by the charter or statutes in force at its adoption, an amendment making a fundamental, radical or vital change in the charter contract, cannot be adopted without unanimous acceptance by the stockholders. The acceptance of an amendment making a material change by a majority of the stockholders will release a subscribing stockholder from liability to pay this subscription or may be ground for an injunction to restrain action under the amendment.

A majority of the stockholders of a corporation clearly have the power to make any alterations or changes in the constitution or powers of the corporation which are authorized to be made by majority vote by its charter, or by a general law in force at the time of the creation of the corporation, for this power is within the contract between the corporation and its stockholders.⁵⁸ The legislature, however, has no power to authorize a majority of the stockholders to bind the minority by accepting such an amendment by a law enacted after the corporation was created, for this would be to impair the obligation of the contract between the corporation and the dissenting stockholders, by forcing them into a different contract, and would therefore be within the constitutional prohibition against laws impairing the obligation of contracts.⁵⁹

⁵⁶ *Eastern R. Co. v. Boston & M. R. R.*, 111 Mass. 125, 15 Am. Rep. 13. See ante, §§ 175, 177. See also, *Maxwell v. Thompson*, 195 N. Y. App. Div. 616, 186 N. Y. Supp. 208, aff'd 232 N. Y. 619, 134 N. E. 596.

⁵⁷ *Perkins v. Coffin*, 84 Conn. 275, 79 Atl. 1070, Ann. Cas. 1912 C 1188; *Randle v. Winona Coal Co.*, 206 Ala. 254, 89 So. 790, 19 A. L. R. 118; *Peters v. United States Mortg. Co.*, 13 Del. Ch. 11, 114 Atl. 598. See 33 *Harvard Law Rev.* 979; 8 *Minnesota Law Rev.* 617; 11 *Cornell Law Quarterly* 70; 75 *Uni. Pa. Law Rev.* 585, 592.

⁵⁸ *Chicago City Ry. Co. v. Allerton*, 18 Wall. (U. S.) 233, 21 L. Ed. 902; *Colgate v. United States Leather Co.*, 75 N. J. Eq. 229, 72 Atl. 126, 19 Ann. Cas. 1262 (change in nature of business by vote of certain per cent); *Weede v. Emma Copper Co.*, 58 Utah 524, 200 Pac. 517; *Salt Lake Automobile Co. v. Keith-O'Brien Co.*, 45 Utah 218, 143 Pac. 1015.

⁵⁹ *Peters v. United States Mortg. Co.*, 13 Del. Ch. 11, 114 Atl. 598; *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617; *Kean v. Johnson*, 9 N. J. Eq. 401; *Allen v. Francisco Sugar Co.*,

The mere fact that a fundamental alteration in the charter of a corporation is beneficial to the corporation cannot give the majority the power to accept it against the dissent of the minority. Nor can it make any difference that the majority, in accepting it, act in good faith, and for what they deem to be the best interests of all the stockholders. A stockholder has a right to stand upon the terms of his contract of membership, and to insist that the funds of the corporation shall not be applied to any other purpose than that authorized by the charter of the corporation when he became a member.⁶⁰

This doctrine was laid down by Lord Eldon in a leading English case, in which the majority of an unincorporated insurance company, formed for the purpose of fire and life insurance, attempted to change its articles so as to authorize it to engage also in the business of marine insurance. An injunction was granted in a suit by a dissenting member, and this notwithstanding an offer by the company to pay him what he had put into the company, with interest.⁶¹ The majority of the members of the association could not embark the firm in the marine insurance business unless the contract of partnership expressly or impliedly gave that authority. A stockholder in a corporation has a similar contract right that its funds shall not be risked in enterprises not authorized in the articles of incorporation. This gives minority stockholders a tremendous hold to restrain radical changes.

This principle has been applied to an amendatory act of the legislature authorizing a railroad company to convey or lease its road and franchises to another company, where its condition is

92 N. J. Eq. 391, 110 Atl. 37; s. c., 92 N. J. Eq. 431, 435, 112 Atl. 887; *Dow v. Northern R. R.*, 67 N. H. 1, 36, Atl. 510; *Kenosha, R. & R. I. R. Co. v. Marsh*, 17 Wis. 13. The rights of a stockholder are fixed by the original charter of the corporation. A buyer of stock whenever purchased comes into the original compact, except as amendments have been adopted by all.

⁶⁰ Fundamental amendments to the incorporation laws, made after the corporation is organized, have no effect to change the powers of the corporation, unless the power to amend in such respects was reserved under the original statute. *Campbell v. American Zylonite Co.*, 122 N. Y. 455,

25 N. E. 853, 11 L. R. A. 596; *Einstein v. Raritan Woolen Mills*, 74 N. J. Eq. 624, 70 Atl. 295; *Stevens v. Rutland & B. R. Co.*, 29 Vt. 545; *Proprietors of Union Locks & Canals v. Towne*, 1 N. H. 44, 8 Am. Dec. 32.

⁶¹ *Natusch v. Irving, Gow, Partnership*, Appendix vi., p. 398. And see *Ashton v. Burbank*, 2 Dill. 435, Fed. Cas. No. 582.

Statutes sometimes give power to the holders of a specified proportion of the stock, say two-thirds, to change the nature of the corporate business and to purchase the shares of dissenting stockholders at a valuation. See *Weiner*, 27 Columbia Law Rev. 547.

not such as to render this necessary;⁶² to an act authorizing a railroad, turnpike, or canal company to construct its road or canal along a different route from that originally authorized, or beyond the original terminus, where the change is so radical as to make the enterprise essentially different from what was originally contemplated;⁶³ to an act authorizing a railroad company or other corporation to consolidate with another corporation;⁶⁴ and to an act changing the number of votes to which each stockholder is entitled under the charter.⁶⁵

Amendments merely in furtherance of the objects of the corporation.—This principle does not apply to alterations or amendments of a charter which do not fundamentally change the character of the corporation, or its objects, but which are merely in furtherance of the objects for which it was created, and for the purpose of enabling it the better to carry out those objects. Such an amendment may be accepted by a majority of the stockholders, against the dissent of the minority, without express provision in the charter or law in force at the time of incorporation, for it may well be held that every stockholder impliedly agrees that he will be bound by the vote of the majority in accepting amendments in furtherance of the original purposes of the corporation.⁶⁶ It has been held, therefore, that a majority of the stockholders of a cor-

⁶² *New Orleans, J. & G. N. R. Co. v. Harris*, 27 Miss. 517: "The rule is unquestioned that in partnerships and joint stock associations, the fundamental articles of partnership or association cannot be altered by a vote of the majority against the consent of the minority, unless there is an express or implied provision in the articles themselves, that they may do it. . . . The charter in these cases constitutes the fundamental articles of the association." The incapacity of the majority to alter, fundamentally, the charter against the consent of even a single stockholder follows.

⁶³ *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617; *Stevens v. Rutland & B. R. Co.*, 29 Vt. 545; *Witter v. Mississippi, Q. & Red River R. Co.*, 20 Ark. 463; *Kenosha, R. & R. I. R. Co. v. Marsh*, 17 Wis. 13.

It is otherwise if the change is not so radical as to make the enterprise different from that originally contemplated. See *infra*, this section.

⁶⁴ *Clearwater v. Meredith*, 1 Wall. (U. S.) 25, 17 L. Ed. 604; *Mowrey v. Indianapolis & C. R. Co.*, 4 Biss. 78, Fed. Cas. No. 9891; *Illinois Grand Trunk R. Co. v. Cook*, 29 Ill. 237; *Booe v. Junction R. Co.*, 10 Ind. 93; *Shelbyville & R. Turnpike Co. v. Barnes*, 42 Ind. 498; *Kenosha, R. & R. I. R. Co. v. Marsh*, 17 Wis. 13; *Kean v. Johnson*, 9 N. J. Eq. 401.

It is otherwise if the consolidation does not radically change the original enterprise. See *infra*, this section.

⁶⁵ *In re Newark Library Ass'n*, 64 N. J. Law 217, 43 Atl. 435.

⁶⁶ *Perkins v. Coffin*, 84 Conn. 275, 79 Atl. 1070, Ann. Cas. 1912 C 1188; *In re Sharood Shoe Corp.*, 192 Fed. 945, 950; *Durfee v. Old Colony & Fall River R. Co.*, 5 Allen (Mass.) 230; *Stevens v. Rutland & B. R. Co.*, 2 Vt. 545; *Schenectady & S. Plank Road Co. v. Thatcher*, 11 N. Y. 102; *Buffalo & N. Y. C. R. Co. v. Dudley*, 14 N. Y. 336; *Park v. Modern Woodmen of America*, 181 Ill. 214, 54 N. E. 932.

poration may accept an amendment of its charter changing its name,⁶⁷ or the number of its directors;⁶⁸ authorizing an increase or reduction of capital stock,⁶⁹ or authorizing the issue of preferred stock for the purpose of raising money to carry out the legitimate objects of the corporation;⁷⁰ or authorizing the corporation to lease or sell, or divide among the stockholders, property not needed for the purposes of the corporation.⁷¹ In *Perkins v. Coffin*,⁷² minority stockholders sought to restrain the Connecticut River Company from accepting an amendment to its charter offered by statute, granting powers for the improvement of navigation, the increase of water power and the production of electrical energy for light, heat and power. This was held not a fundamental change in the objects and character of the corporation which was already authorized to maintain a water power. When accepted by a majority of the stockholders it became binding on the dissenting minority.

Effect of reservation by the state of the power to alter, amend, or repeal charters.—As a rule, in granting charters or authorizing the creation of corporations under general laws, the state, as we have seen in a former section expressly reserves the power of alteration, amendment, or repeal, and such a reservation, of course, becomes a part of the contract between the state and the corporation, and is binding, not only upon the corporation, but also upon

⁶⁷ *Taggart v. Western Maryland R. Co.*, 24 Md. 563, 89 Am. Dec. 760.

⁶⁸ *Mower v. Staples*, 32 Minn. 284, 20 N. W. 225: "Amendments which do not change the nature, purpose or character of the corporation or its enterprise, but which are designed to enable the corporation to conduct its authorized business with greater facility, more beneficially or more wisely are auxiliary to the original object." See *Perkins v. Coffin*, 84 Conn. 275, 79 Atl. 1070, Ann. Cas. 1912 C 1188; *Lord v. Equitable Life Assur. Soc.*, 194 N. Y. 212, 87 N. E. 443, 22 L. R. A. (N. S.) 420, 423.

⁶⁹ *Rice v. Rock Island & A. R. Co.*, 21 Ill. 93; *Troy & Rutland R. Co. v. Kerr*, 17 Barb. (N. Y.) 581. And see *Durfee v. Old Colony & Fall River R. Co.*, 5 Allen (Mass.) 230; *Buffalo & N. Y. C. R. Co. v. Dudley*, 14 N. Y. 336. But see *Goswick v.*

Alpharetta Bank, 143 Ga. 309, 85 S. E. 112.

⁷⁰ *Rutland & B. R. Co. v. Thrall*, 35 Vt. 536; *Chaffee v. Rutland R. Co.*, 55 Vt. 110; *City of Covington v. Covington & C. Bridge Co.*, 10 Bush (Ky.) 69; *Curry v. Scott*, 54 Pa. St. 270; *Williston v. Michigan Southern & N. I. R. Co.*, 13 Allen (Mass.) 400; *Hinckley v. Schwarzschild & Sulzberger Co.*, 45 N. Y. Misc. 176, 91 N. Y. Supp. 893; s. c., 107 N. Y. App. Div. 470, 95 N. Y. Supp. 357, 363.

⁷¹ *Webster v. Cambridge Female Seminary*, 78 Md. 193, 28 Atl. 25; *Merchant v. Western Land Ass'n*, 56 Minn. 327, 57 N. W. 931.

That the legislature may authorize a waterworks corporation, by vote of the majority, to sell its plant to the city, see *Peabody v. Westerly Water Works*, 20 R. I. 176, 37 Atl. 807.

⁷² 84 Conn. 275, 79 Atl. 1070, Ann. Cas. 1912 C 1188.

every individual stockholder.⁷³ No stockholder, therefore, can successfully contend that his contract with the corporation is impaired by any amendment of the charter of the corporation which comes properly within such a reservation. The difficulty has been in construing such a reservation and determining what amendments are properly within it, and on this question there has been some difference of opinion.

In some of the cases in which the courts have been called upon to determine the power of the majority of the stockholders of a corporation to bind a dissenting minority by accepting and continuing under an amendment of its charter, great stress has been placed upon the fact that the state had reserved the power to alter, amend, or repeal the charter; and because of such a reservation, the majority of the stockholders have been allowed to bind the minority by accepting an amendment of a charter made for the benefit of the corporation, and adding to the powers of the corporation so as materially to change the enterprise for which it was originally created, where the additional powers conferred were of the same general kind as those originally conferred.⁷⁴

In a Massachusetts case, where a railroad company had been created for the purpose of constructing and operating a railroad from Fall River to Boston, and the charter was amended so as to authorize the company to extend its road from the terminus in Fall River to the Rhode Island line, and to unite with a railroad from the latter point to Newport, in Rhode Island, it was held that, as the state had reserved the power to alter or amend the charter of the company, this reservation was binding on the stockholders, and that a majority could bind a dissenting minority by accepting the amendment, by constructing a road to the Rhode Island line, and by leasing the road of another company from the latter point to Newport for ten years at an annual rent, to be paid for the full term in advance, and to be used by the latter company in constructing its road. The court held that a dissenting stockholder could not maintain a suit for an injunction, and he was therefore forced, against his will, into a clearly different enterprise from that originally contemplated.⁷⁵ There was a similar decision

⁷³ Ante, §§ 277, 278; *Durfee v. Old Colony & Fall River R. Co.*, 5 Allen (Mass.) 230.

⁷⁴ *Durfee v. Old Colony & Fall River R. Co.*, 5 Allen (Mass.) 230; *Buffalo & N. Y. C. R. Co. v. Dudley*,

14 N. Y. 336; *Perkins v. Coffin*,^{*} 84 Conn. 275, 79 Atl. 1070, Ann. Cas. 1912 C 1188.

⁷⁵ *Durfee v. Old Colony & Fall River R. Co.*, 5 Allen (Mass.) 230.

in New York, where a railroad company had been created for the purpose of constructing and operating a railroad from Hornellsville to Attica, and its charter was amended so as to authorize it to extend its road to Buffalo, thirty-one miles beyond Attica, and to increase its capital stock for such purpose from \$750,000 to \$1,500,000. It was held that the amendment did not release a dissenting stockholder from liability on his subscription.⁷⁶

The reasoning of the Massachusetts court in the case above referred to is based upon the assumption that the reservation by the state of the power to alter, amend, or repeal the charter of a corporation is intended, not merely for the protection of the public, but also to enable the legislature to authorize a corporation to engage in new enterprises solely for its own benefit, and whether any interests of the public are concerned or not, but such a construction is not supported by the weight of authority. The true view is that the power to alter, amend, or repeal charters is reserved by the state *solely* for the purpose of avoiding the effect of the decision in the *Dartmouth College* case,⁷⁷ that the charter of a corporation is a contract between the state and the corporation within the constitutional prohibition against laws impairing the obligation of contracts, and of enabling the state to impose such restraints upon corporations as the legislature may deem advisable for protection of the public, and not for the purpose of avoiding the effect of the doctrine in *Natusch v. Irving* that the charter is a contract between the corporation and the stockholders, or between the associates *inter se*.⁷⁸

Such power is not reserved in any sense for the benefit of the corporation, or of a majority of the stockholders. The power of a majority of the stockholders to bind a dissenting minority by accepting an amendment of the charter does not depend at all upon whether the state has reserved to itself the power to alter or amend the charter, but depends "essentially upon the question whether the change is of such a character that it may be deemed so far in furtherance of the original undertaking, and incidental to it, as to be fairly within the power of the corporation to bind its individual members by its corporate assent, or whether it is such a departure from the original purpose that no member should be deemed to have authorized the corporation to assent to it for him," or upon

⁷⁶ *Buffalo & N. Y. C. R. Co. v. Dudley*, 14 N. Y. 336.

⁷⁷ *Ante*, § 271.

⁷⁸ *Supra*, this section, notes 59, 60; see 75 *Uni. Pa. Law Rev.* 585.

a reservation in the charter contract of a power in the majority stockholders to make fundamental changes.⁷⁹

According to this doctrine, even when the state has reserved the power to alter, amend, or repeal a charter, a majority of the stockholders cannot bind a dissenting minority by acceptance of an amendment which is so radical a change as to authorize the corporation to engage in a different enterprise from that for which it was created. It has been held, therefore, contrary to the Massachusetts and New York cases above referred to, that such a reservation does not enable a majority of the stockholders to accept an amendment authorizing the company to extend its road considerably beyond the terminus originally fixed, and to increase its capital stock for such purpose, or to consolidate with another company with which it connects, or to materially change its route.⁸⁰ But a majority of the stockholders of a railroad or turnpike company may accept an amendment changing its route, or authorizing an extension of its road, if the change or extension is not so great as to make the enterprise radically different from what was originally contemplated, but is merely in furtherance of the original purpose.⁸¹

§ 282. Amendments authorized by charter.

Many incorporation laws show an intention to confer almost unlimited power on the corporation acting by a majority of the stockholders, often specified as two-thirds in amount of stock, to adopt amendments changing the purposes and objects of the corporation, the rights and preferences of stockholders and making almost any other alteration of the charter contract which may be desired.⁸² Under such provisions as to amendment, which are

⁷⁹ *Kenosha, R. & R. I. R. Co. v. Marsh*, 17 Wis. 13; *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617; *Dow v. Northern R. R.*, 67 N. H. 1, 36 Atl. 510; *Old Town & L. R. Co. v. Veazie*, 39 Me. 571; *Mills v. Central R. Co.*, 41 N. J. Eq. 1; *In re Election of Directors of Newark Library Ass'n*, 64 N. J. Law, 217, 43 Atl. 435. See *Garey v. St. Joe Min. Co.*, 32 Utah 497, 91 Pac. 369, 12 L. R. A. (N. S.) 554.

⁸⁰ *Zabriskie v. Hackensack & N. Y. R. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617; *Kenosha, R. & R. I. R. Co. v. Marsh*, 17 Wis. 13.

⁸¹ *Sprague v. Illinois River R. Co.*, 19 Ill. 174; *Ross v. Chicago, B. & Q. R. Co.*, 77 Ill. 127; *Milford & C.*

Turnpike Co. v. Brush, 10 Ohio 111, 36 Am. Dec. 78; *Irvin v. Susquehanna & P. Turnpike Road Co.*, 2 Pen. & W. (Pa.) 470, 23 Am. Dec. 53; *Cross v. Peach Bottom Ry. Co.*, 90 Pa. St. 392; *Pacific R. Co. v. Hughes*, 22 Mo. 291, 64 Am. Dec. 265; *Chattanooga, R. & C. R. Co. v. Warthen*, 98 Ga. 599, 25 S. E. 988.

⁸² If power to make alterations is granted by the general incorporation law in force at the time preferred stock is issued, new classes of preferred stock may be created with priority as to dividends over the outstanding preferred stock. *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 Atl. 696; 11 Cornell Law Quarterly 70; 8 Minnesota Law Rev.

written in to the charter contract at the time of incorporation, fundamental changes may be adopted which will force the minority to engage in a business entirely different from that into which they entered. The distinction to be observed is between the reservation to the state of the power to alter or amend the charter for the public benefit and the reservation in the charter contract of power to the corporation acting by a majority to bind a dissenting minority by changes which are aimed to promote the interests of those engaged in the corporate enterprise.

Even a provision that the articles may be amended in any respect at any stockholders' meeting by a majority vote of the outstanding capital stock might not be interpreted to give the majority the authority to alter or change the fundamental purpose or character of the corporation or to substitute entirely different articles for the original or to make unreasonable and oppressive amendments, not germane to carrying out the original enterprise. It has been held, however, that a majority of the stockholders may by amendment change the relative priorities of preferred stock where the power is granted by the incorporation law in force at the time the preferred stock was issued. If the articles or statutes of incorporation provide that the charter may be amended "in any respect" by a certain vote, the required number of shares may make fundamental changes without unanimous consent.⁸³ So an amendment changing stock from a par value of \$100 per share to nonpar stock, increasing the number of shares, and providing for preferred stock is valid, the power to amend being written into the charter. The change being duly adopted by a two-thirds vote

617; *Peters v. United States Mortg. Co.*, 13 Del. Ch. 11, 114 Atl. 598; *Mercantile Statement Co. v. Kneal*, 51 Minn. 263, 53 N. W. 632. Amendment to include additional business authorized by statute to be adopted by majority vote of directors and stockholders.

⁸³ *General Inv. Co. v. American Hide & Leather Co.*, 98 N. J. Eq. 326, 129 Atl. 244, 44 A. L. R. 60; *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 Atl. 696, 697; *Peters v. United States Mortg. Co.*, 13 Del. Ch. 11, 114 Atl. 598; *Salt Lake Automobile Co. v. Keith-O'Brien Co.*, 45 Utah 218, 143 Pac. 1015; 11 *Cornell Law Quarterly*, 78; *Palmer Company Law* (11th Ed.) p. 100.

In *General Inv. Co. v. American*

Hide & Leather Co., supra, it is held that a corporation may by amendment create new classes of preferred stock which confer upon the holders rights superior to those of previous issues of preferred stock, and this does not violate the contract rights of the stockholders, because the power of amendment in this respect is under the law in force at the time of creation an integral part of the charter and of the stockholder's contract.

In some states a stockholder who does not assent to a vote to change the nature of the business of the corporation is given the privilege by statute to demand payment for his stock at an appraised price. *Teale v. Rockport Granite Co.*, 224 Mass. 20, 112 N. E. 497; 27 *Columbia Law Rev.* 547.

does not violate any right of the minority.⁸⁴ It may indeed be a doubtful question of statutory construction whether a mere general power to amend should be interpreted as giving power to issue new classes of preferred stock to which outstanding issues should be subordinated by less than unanimous consent.⁸⁵

The certificate of incorporation of the Tidewater Associated Oil Company, organized under the laws of Delaware, contains the following provision with reference to new issues of preferred stock:

“*Fourth:* 1. The total number of shares of the corporation’s authorized capital stock is Eleven Million, Five Hundred Thousand shares (11,500,000) of which One Million, Five Hundred thousand (1,500,000) of the par value of One Hundred dollars (\$100) each are to be preferred stock and Ten Million (10,000,000) are to be common stock without nominal or par value. From time to time either class of stock may be increased or decreased or the class of common stock without nominal or par value may be altered or changed, or one or more additional classes of stock may be created with such preferential, special or qualified rights as may be determined by the Board of Directors and the stockholders having voting rights to the extent and in the manner permitted by the statutes of the State of Delaware; provided, however, that the amount of preferred stock now authorized shall not be increased, and no different or additional class of stock shall be created which shall be on a parity with or preferred over the preferred stock now authorized in respect of payments of dividends or of payments on liquidation or dissolution, if there shall be filed with the corporation by the holders of record of thirty-three and one-third per centum (33 1-3%) in par value of the preferred stock now authorized and then outstanding, written objection thereto, within twenty days after the mailing to the then preferred stockholders of written notice of any such proposed action.”

§ 283. Blue Sky legislation.

Prior to 1911 there were no Blue Sky Laws. In 1911 the Kansas legislature passed “An act to provide for the regulation and supervision of investment companies and providing penalties for the

⁸⁴ *Randle v. Winona Coal Co.*, 206 Ala. 254, 89 So. 790, 19 A. L. R. 118. See 14 C. J. 190, 191.

⁸⁵ *Pronick v. Spirits Distributing*

Co., 58 N. J. Eq. 97, 42 Atl. 586. See *Nelson v. Keith-O’Brien Co.*, 32 Utah 396, 91 Pac. 30; 11 Cornell Law Quarterly 78.

violation thereof" (ch. 133, Laws 1911). This law, popularly called "the Blue Sky Law," has attracted wide attention and somewhat similar legislation has been enacted in all states except Delaware, Nevada, Maryland, and New York, to protect investors against concerns which have nothing behind their stock certificates but water or "blue sky."⁸⁶ The name "Blue Sky Law" indicates the evil at which it is aimed, that is "speculative schemes which have no more basis than so many feet of blue sky"; or as it has been stated, "to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines, and other like fraudulent exploitations."⁸⁷

It is the effort of this legislation to provide a reasonable method of having schemes in which the public are invited to intrust their funds to the management and control of others safeguarded by some reasonable method of examination by public authority, requiring those who would sell securities to the public to make a showing of good faith, solvency and a reasonable chance of return on the investment. Prevention of fraud is far more useful than punishment. These statutes regulate corporation financing in great detail and give to administrative officials great power and discretion over the activities of promoters and dealers offering stock and bonds and securities of incorporated and unincorporated companies for public sale. "The typical law places two checks upon the issuance of securities: first, in the form of licensing of dealers, and second, in the requirement that each issue which the dealer offers for sale must have passed the watchful scrutiny of the Securities Commission."⁸⁸

Criticism is urged against these laws by many lawyers and business men that they unduly burden, delay and hamper normal business enterprises, cause great expense and inconvenience to

⁸⁶ Reed and Washburn, *Blue Sky Laws*; L. L. Cowan, *Manual of Securities Laws and Service*; on *Blue Sky Laws* generally, see 37 C. J., *Licenses*, p. 270; 8 C. J., p. 1130; 19 *Michigan Law Rev.* 590; 14 *Illinois Law Rev.* 356, 367, W. B. Hale, *The new Corporation Act and The Securities Law*; 7 *Minnesota Law Rev.* 61, 431, Brown, *a Review of Cases on Blue Sky Legislation*; 2 *Wisconsin Law Rev.* 86, Richards.

⁸⁷ In *State v. Whiteaker*, 118 Ore. 656, 247 Pac. 1077, it appeared that the defendant claimed to have invented an electrical device which would

extract gold from the waters of Mono Lake, California. In order to promote this scheme certain "units of interest" were offered to the public. It was held that the term "securities" in *Blue Sky Laws* included such instruments of investment. See 37 C. J. 270, 275.

⁸⁸ *Blue Sky Laws*, 24 *Columbia Law Rev.* 79, 80. See *Alabama Public Service Commission v. Mobile Gas Co.*, 213 Ala. 50, 104 So. 538, 41 A. L. R. 872, 889, n. *Regulating issuance of securities by public utilities, through public service commissions.*

legitimate corporations, and subject them to arbitrary executive power and discretion.⁸⁹ A wide discretion is necessarily granted to administrative boards and officials charged with granting or refusing permits. The test to be applied may be "whether the securities are of such a nature that their sale would work a fraud upon the purchaser." The commissioner is commonly authorized to ascertain whether the investment concern is solvent and its articles or constitution contain a fair, just and equitable plan of business, or whether investors are invited to entrust their funds under a contract or plan which is unfair and unjust, and whether the concern does not intend in good faith to do a fair and honest business. It seems impossible to lay down more definite standards to guide the issue of permits.⁹⁰

Among the evils and abuses in connection with promotion of corporations which led to the enactment of blue sky laws were: (1) the charging of exorbitant commissions for the sale of stock sometimes amounting to 30, 40 or 50 per cent, or even more, of the selling price; (2) the promotion of enterprises with no reasonable chance of success, such as patented devices mechanically imperfect or impracticable, or the development of mines and other enterprises not worth developing; (3) grossly excessive valuations claimed for assets to justify a price for a stock, and the issuance of large blocks of stock for "good will" or other intangible assets.⁹¹ As the Illinois court says:⁹² "The object of the law is to protect the public from the dishonesty, incompetence, ignorance and irresponsibility of persons engaged in the business of disposing of securities of uncertain value whereby the inexperienced and confiding are likely to suffer loss. . . . Sales by unknown and nonresident vendors and sleek peripatetic salesmen, with glib tongues and indurated consciences, of stock and other securities for the purpose of developing wild-cat oil fields in distant states,

⁸⁹ See Richards, 2 Wisconsin Law Rev. 86.

⁹⁰ 24 Columbia Law Rev. 79, 81, 82. See The Corporate Securities Act, Benas, 14 California Law Rev. 101, 104, 108, 110: "The Blue Sky Law has a laudable aim, but it must be remembered that in almost every section it encounters a conflict between the freedom of legitimate business and the prevention of frauds; and that legitimate business houses are by far in the majority."

⁹¹ Groby v. State, 109 Ohio St.

543, 143 N. E. 126: "All these provisions clearly evince the purpose of the Legislature to bring within the regulatory provisions of the act, not only sales of stock after incorporation, but subscriptions for stock before incorporation, as well as the sale of all instruments known as securities, whether of corporations, associations, or partnerships, except those specifically exempted by this law."

⁹² Stewart v. Brady, 300 Ill. 425, 133 N. E. 310.

mythical rubber plantations in Guatemala, or imaginary copper mines in Mexico, for extracting gold from sea water and light from cucumbers, and developing power from the rise and fall of the tides, and for hundreds of visionary schemes, domestic and foreign, designed to secure a great return from a small investment in a short time, fall within the terms of the act."

The leading case on the validity of such regulation is *Hall v. Geiger-Jones Co.*,⁹³ which involved the issuance of a broker's license to operate and to transact business in corporate securities under the Ohio Blue Sky Law. It was held that in the exercise of the power to prevent fraud and imposition, a state may forbid dealing in stocks and other securities within its borders without a license, and subject the business to executive supervision. The granting of the license may be conditioned upon a determination by an executive officer that the dealer is of good business repute, and the license may be made revocable if the commissioner ascertains that the licensee is (a) of bad business repute; (b) has violated any provision of the statute; (c) has engaged or is about to engage in illegitimate business or fraudulent transactions. Such act does not confer arbitrary power. There is a presumption that the duties entrusted to the commissioner under the Blue Sky Law will be executed in the public interest and not wantonly or arbitrarily to deny a license or to take away one from a reputable dealer.

Safeguards.—"Almost every statute designates certain exempted transactions, securities or persons to whom the ordinary restrictions do not apply. These exemptions have gradually increased, as practice has shown that numerous cases exist in which no regulation is needed. . . . Of these exemptions probably the most noteworthy is that which was first adopted by Michigan, providing that that act should not apply to securities, "which are listed in any standard manual of information approved by the commission." So securities listed on recognized stock exchanges are exempted.⁹⁴ The exemption of securities listed on recognized

⁹³ 242 U. S. 539, 61 L. Ed. 480, 37 Sup. Ct. 217, L. R. A. 1917 F 514, Ann. Cas. 1917 C 643. See also, *Caldwell v. Sioux Falls Stock Yards Co.*, 242 U. S. 559, 37 Sup. Ct. 224, 61 L. Ed. 493 (South Dakota Blue Sky Law does not violate 14th Amendment); *Merrick v. N. W. Halsey & Co.*, 242 U. S. 568, 37 Sup. Ct. 227,

61 L. Ed. 498 (Michigan Blue Sky Law does not deny equal protection of laws or give commission arbitrary discretion). See Laylin, *The Ohio Blue Sky Cases*, 15 Michigan Law Rev. 369; 7 Fletcher, *Corporations*, sec. 4421.

⁹⁴ Blue Sky Laws, 24 Columbia Law Rev. 79; *Stewart v. Brady*, 300

stock exchanges is based on the safeguards which this implies as to investigation and competitive market price, and the publication of market reports, so that they are not within the evil of fraudulent promotions.

The provisions of a typical Blue Sky Law, such as that of Wisconsin, California or Michigan, are summarized as follows by Dean Richards in the *Wisconsin Law Review*:⁹⁵ "A typical blue sky law embodies the following features: (1) It forbids the sale of securities, except certain exempt classes, except upon conditions prescribed by it. (2) All dealers in securities must obtain a license to do business from the official charged with administering the law. In granting or refusing the license, the official or officials, usually a special commission for the purpose, must be furnished, if they require it, complete data on the applicant's business, and class of securities to be dealt in. (3) Where a security to be offered is within the law, the commission has wide powers. Detailed information as to the issuing company, its character, powers, properties, stock issues, and business is required. Appraisals or audits may be required or an investigation of the company's affairs by the commissioner or his agents. If the commission is satisfied with the showing made, it may authorize a sale with or without conditions. (4) In many instances the commission classifies the securities as Class A or Class B, the latter being denominated speculative. (5) Penalties varying from a misdemeanor to a crime are inflicted for essential misrepresentations by brokers or corporate officials presenting the information required by the commission. . . .

"The provision requiring the licensing of dealers is one of the most effective provisions of the act, and is generally approved as calculated to eliminate itinerant and irresponsible agents, the medium through which fraudulent securities are most commonly marketed. The licensing method of control is also familiar and well established. . . .

"An application to the commission for permission to sell a security must be accompanied by a very detailed statement of assets and liabilities with an explanation of each item; the income account, if a going business; a copy of the security proposed to be offered, a copy of the prospectus, or other advertising matter proposed to be used in marketing the security; an appraisal of the property by a

Ill. 425, 133 N. E. 310; 14 California Law Rev. 115.

⁹⁵ H. S. Richards, *Watered Stock*

and Blue Sky Legislation, 2 Wisconsin Law Rev. 86, 94, 98, 99, 100.

For an account of the California

competent person accompanied by a statement of his experience and qualifications; and all the facts on which the appraisal is based; the amount and nature of the purchase price of securities issued for patents, copyrights, trade-marks, trade processes, good will, promotion fees and intangible assets; copies of the articles of association of the corporation, partnership, or other form of association applying for a permit. In addition, the commission may make a detailed examination or audit of the affairs of the applicant at the latter's expense.

"After examining the evidence, a permit may be granted 'if it appears to the commission that the proposed plan of business of the company issuing the securities is not *unlawful, unfair, unjust or inequitable*, and that the company intends to fairly and honestly transact its business and that the securities which it is proposed to issue or sell and the methods to be used in the issue or sale of the securities, are not such as will work a fraud on the purchaser.'

"The commission shall issue a written permit 'in such form as may be prescribed by the commission, authorizing the sale of such securities as therein provided in such amounts and for such considerations, and *upon such terms and conditions as the commission may in said permit provide.*' "

In California the corporation commissioner is required to investigate concerning the assets of a company and to refuse a permit to sell securities unless upon investigation he finds that the proposed plan of business is not unfair, unjust or inequitable, and that the company intends fairly and honestly to transact its business, and that the securities it proposes to issue are not such as to work a fraud upon the purchaser. The applicant for a permit must furnish an itemized account of its financial condition, the amount of its assets and liabilities and a detailed statement of the plan upon which it proposes to transact business.⁹⁶ The permit is usually issued upon certain conditions designed for the protection of the investor, the general purpose of which is to insure that a certain amount of tangible assets shall be acquired by the company. Reports may be required as to money or other assets received, or a showing that the proceeds from the sale of securities have been used in accordance with the permit. In many cases when stock is issued for services or property, the permit requires such stock to

law and its operation, see The Corporate Securities Act, Benas, 14 Cal-ifornia Law Rev. 101.

⁹⁶ Ex parte Girard, 186 Cal. 718, 200 Pac. 593.

be held in escrow, to be released only when the company's business is established.⁹⁷ The supervision of securities by the legal, accounting and engineering departments of the corporation commission probably has an effect upon corporate financing in checking the over-enthusiasm of the promoter, decreasing the amount of stocks to be issued, changing the type of securities, increasing the assets behind them and making more conservative and reasonable the plans of operation.

Some statutes expressly make sales and contracts of sale entered into in violation of the act, that is without a permit or contrary thereto, "void at the instance of the purchaser," and give him the power to demand back the purchase price from the seller or from any one who shall have knowingly furthered the sale. Most courts have held voidable a sale of stock by a corporation which has not complied with the Blue Sky Law, even in the absence of express provision. The purchaser may recover the amount he has paid upon the return of the securities which he has received. He may also defend against an action on notes given for the price of stock or securities, unless the notes have come into the hands of a *bona fide* purchaser for value.⁹⁸ A purchaser will be estopped as against a creditor to defend against statutory stockholder's liability on the ground that the stock was sold in violation of the Blue Sky Law when he affirmed the purchase by retaining the certificate, although he could have rescinded by timely disaffirmance.⁹⁹

In *Edward v. Ioor*,¹⁰⁰ the Arizona Piano Co. sold some of its stock to plaintiff in Michigan. The consideration given consisted of stocks in two other corporations. The Arizona Piano Co. had not secured a permit from the Michigan Securities Commission to sell its stock in the state. Plaintiff sued to recover the value of the stocks assigned to the Arizona Piano Co. in exchange. It was held that the purchaser was entitled to rescind the unauthorized transaction and get back the stocks he had parted with or their value.

⁹⁷ *Agnew v. Daugherty*, 189 Cal. 446, 209 Pac. 34: "The terms and conditions to be prescribed in the permit must not be such as would make a greater burden than is consistent with safety and security."

⁹⁸ *Ashley & Rumelin, Bankers v. Brady*, 41 Idaho 160, 238 Pac. 314; *Planters' Bank & Trust Co. v. Felton*, 188 N. C. 384, 124 S. E. 849, 856.

⁹⁹ *Parker v. Merritt*, 164 Minn. 305, 204 N. W. 941; *In re Racine Auto*

Tire Co., 290 Fed. 939.

¹⁰⁰ 205 Mich. 617, 172 N. W. 620, 15 A. L. R. 256, 262n. See also, 30 A. L. R. 1324, 1331n; *Farm Products Co. of Michigan v. Jordan*, 229 Mich. 235, 201 N. W. 198. Contra, *Warren People's Market Co. v. Corbett & Sons*, 114 Ohio St. 126, 151 N. E. 51; *Watters & Martin v. Homes Corp.*, 136 Va. 114, 116 S. E. 366; 35 Yale Law Journal 881, 882; 14 California Law Rev. 120.

CHAPTER XXII.

FOREIGN CORPORATIONS.

I. STATUS OF A FOREIGN CORPORATION; DOING BUSINESS IN OTHER STATES; COMITY.

§ 284. What corporations are foreign.

A corporation created by or under the laws of a particular state or country is called, with respect to that state or country, a "domestic corporation." A "foreign corporation" is one which owes its existence to the laws of another state, government, or country. Owing to the vast numbers of corporations whose business activities transcend the limits of a single state, and also to the extent to which purely local concerns procure foreign charters, the power of the state to impose harsh terms as the price of admission, and to make them subject to service of process, taxation and qualification conditions becomes of vital moment in the conduct of the business life of the country.

If a corporation is chartered by different states under the same name, clothed with the same powers for the same purposes, with the same directors and officers, and the same stockholders, it is a separate and distinct person in each state and not a single corporation existing under the laws of all the states. For jurisdictional purposes there are separate corporations. Such a corporation is to be treated in any particular one of the states as a domestic corporation to the extent of its existence and action under the government of that state, and as a foreign corporation as regards the other sources of its existence.¹

¹ *Vaughan v. Nashville, C. & St. L. Ry. Co.*, 192 Ky. 137, 232 S. W. 411, 18 A. L. R. 124, 130n; 4 Columbia Law Rev. 391. See *Magna Oil & Refining Co. v. White Star Refining Co.*, 280 Fed. 52.

In *Geoffroy v. New York, N. H. & H. R. Co.*, 13 Fed. (2d) 947, where stockholders of a Connecticut railroad corporation were voluntarily in-

corporated under the same name by the laws of Rhode Island, the corporation is a citizen of Rhode Island for purposes of jurisdiction of a federal court in Rhode Island, and cannot be sued in that court by a citizen of Rhode Island on the ground of diversity of citizenship as a corporation of Connecticut where it was first incorporated.

While a state may incorporate an association existing as a corporation under the laws of another state, so as to make it also a domestic corporation, a statute granting privileges to a foreign corporation does not necessarily have this effect. It may be a mere license, and not an act of incorporation; and whether it is the one or the other depends upon the intention of the legislature, to be gathered from a construction of the whole act. A statute which merely recognizes a corporation created by the laws of another state, and authorizes it to hold property and do business within the state, does not make it a domestic corporation.²

A corporation created by congress in the exercise of its powers as the local legislature for the District of Columbia or a territory is a citizen and resident of the District of Columbia or the territory, as the case may be, and is a foreign corporation with respect to the states.³ This is not true, however, of a corporation created by congress in the exercise of its powers as the legislature for the United States, and not as the local legislature for a particular territory.⁴ But national banking associations, for jurisdictional

² *Baltimore & O. R. Co. v. Harris*, 12 Wall. (U. S.) 65, 20 L. Ed. 354; *Louisville, N. A. & C. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552, 43 L. Ed. 1081, 19 Sup. Ct. 817; *Vaughan v. Nashville, C. & St. L. Ry. Co.*, 192 Ky. 137, 232 S. W. 411. See note 18 A. L. R. 130; *Magna Oil Refining Co. v. White Star Refining Co.*, 280 Fed. 52; *Aspinwall v. Ohio & M. R. Co.*, 20 Ind. 492, 83 Am. Dec. 329; *State v. Delaware, L. & W. R. Co.*, 30 N. J. Law 473; *In re Prime's Estate*, 64 Hun 50, 18 N. Y. Supp. 603, aff'd 136 N. Y. 347, 32 N. E. 1091, 18 L. R. A. 713; *Cook v. Hager*, 3 Colo. 386; *Baltimore & O. R. Co. v. Cary*, 28 Ohio St. 208. Compare, however, where statutes were construed as acts of incorporation and not mere licenses, *Western & A. R. Co. v. Roberson*, 61 Fed. 592; *Grangers' Life & Health Ins. Co. v. Kamper*, 73 Ala. 325; *Quincy Railroad Bridge Co. v. Adams County*, 88 Ill. 615; *Graham v. Boston, H. & E. R. Co.*, 118 U. S. 161, 30 L. Ed. 196, 6 Sup. Ct. 1009.

In some jurisdictions it is expressly provided by statute that foreign corporations, or a certain class of foreign corporations, desiring to do business in the state, shall become a

domestic corporation by filing with the secretary of state copies of their charter and by-laws, duly authenticated, and that, when such a corporation has complied with the statute, it shall immediately become a corporation of the state, and shall enjoy all the privileges, and be subject to the liability, of state corporations, as if it had been originally created under the laws of the state, etc. Under such a statute, a corporation which has complied therewith by filing a copy of its charter and by-laws becomes, *ipso facto*, a domestic corporation, and not a mere licensee to do business in the state. *Debnam v. Southern Bell Telephone & Telegraph Co.*, 126 N. C. 831, 36 S. E. 269, 65 L. R. A. 915; *Southern R. Co. v. Allison*, 190 U. S. 326, 47 L. Ed. 1078, 23 Sup. Ct. 713.

³ *Hadley v. Freedman's Savings & Trust Co.*, 2 Tenn. Ch. 122; *Daly v. National Life Ins. Co.*, 64 Ind. 1; *Williams v. Creswell*, 51 Miss. 817; *Layden v. Endowment Rank, K. P. of the World*, 128 N. C. 546, 39 S. E. 47.

⁴ *Commonwealth v. Texas & P. R. Co.*, 98 Pa. St. 90; *Gould v. Texas & P. R. Co.*, 176 N. Y. App. Div. 818, 163 N. Y. Supp. 479.

purposes, are domestic corporations in the states in which they are located, and are foreign corporations in other states.⁵

§ 285. Power of corporations to do business in other states; comity.—A corporation, while it may be refused recognition in other jurisdictions, has the power to engage in business, make contracts, and maintain suits in other states, through its agents, with the consent of such other states, express or implied. And by comity between states, it may engage in business in other states, make contracts therein, and maintain suits, provided its doing so is not contrary to any express constitutional or statutory prohibition, nor contrary to the laws or public policy of the state.

It is within the power of a state, by a constitutional provision or an act of the legislature, to exclude foreign corporations altogether, or to prescribe such conditions as they may see fit, so long as they violate no provision of the Federal Constitution or the constitution of the state.

A corporation, since it arises from a grant of legal privilege, and since the laws of a state or country have no extraterritorial force, need not be recognized beyond the limits of the state or country by which it was created. "It must dwell in the place of its creation, and cannot migrate to another sovereignty."⁶ In other words, a corporation derives its privileges and capacity by grant of the state of incorporation. But these legal rights may be recognized by foreign law, just as a contract, a title, a marriage or a partnership created in one state may be recognized elsewhere, and usually will be so recognized. It does not follow, therefore, from the theory of nonexistence of a corporation outside the state of its origin, that it cannot do business and make contracts in another state or country; for a corporation, may have agents, and may act through these agents in jurisdictions in which it has no existence itself; just as a natural person may reside in one state and act through an agent in another. It is well settled, therefore, that a foreign corporation has the power, through agents duly appointed or authorized by it, to engage in business, provided the other state

⁵ United States Judicial Code, sec. 24. See *American Bank & Trust Co. v. Federal Reserve Bank of Atlanta*, Ga., 256 U. S. 350, 65 L. Ed. 983, 41 Sup. Ct. 499, 25 A. L. R. 971; *Fresno Nat. Bank v. Superior Court*, 83 Cal. 491, 24 Pac. 157.

⁶ *Bank of Augusta v. Earle*, 13 Pet.

(U. S.) 519, 10 L. Ed. 274; *Duke v. Taylor*, 37 Fla. 64, 19 So. 172, 31 L. R. A. 484, 53 Am. St. Rep. 232; *People v. Women's Home Missionary Soc. of M. E. Church*, 303 Ill. 418, 135 N. E. 749. See *Henderson*, *The Position of Foreign Corporations in Amer. Const. Law*, pp. 48, 174.

or country does not expressly or impliedly prohibit it from so acting within its limits.⁷

Statements that a corporation must exist and reside in the state which created it, and cannot migrate to another state are mere figures of speech which do not mean that there is any rule of law which restricts a corporation in its transactions to one state. "The right to carry on the business of a corporation in a foreign state undoubtedly depends upon the consent of that state, but that consent is almost universally accorded as a matter of comity." In *Turcott v. Yazoo & M. V. R. Co.*,⁸ it is said: "It may be conceded that with such consent they lawfully may, as they often actually do, remove their officers, agents, offices and effects into another sovereignty, and there exercise their functions and franchises. In such a case where is the corporation? If it can be said that it still dwells in the place of its creation, and is acting elsewhere only by agents, the answer is, no more by agents elsewhere than in the place of its creation. It can do nothing anywhere, nor manifest its presence or being at all, except through its agents, its property or its operation." *Bank of Augusta v. Earle*⁹ involved the power of the Bank of Augusta, chartered by the state of Georgia, and invested by its charter with the power of dealing in bills of exchange, to exercise that power in the state of Alabama. It was there held that the recognition of foreign corporations and their right to sue and make contracts in other states depends wholly upon comity. It is not necessary that a corporation should exist or be present in the sovereignty or state in which it contracts. It is sufficient if its existence as a corporation in the state of its creation is recognized by the law of the place where it does business. Accordingly the purchase of bills of exchange in Alabama by a Georgia corporation was held valid.

⁷ *Bank of Augusta v. Earle*, 13 Pet. (U. S.) 519, 10 L. Ed. 274; *Thomas v. Matthiessen*, 232 U. S. 221, 58 L. Ed. 577, 34 Sup. Ct. 312; *Boyette v. Preston Motors Corp.*, 206 Ala. 240, 89 So. 746, 18 A. L. R. 1376.

⁸ 101 Tenn. 102, 45 S. W. 1067, 40 L. R. A. 768, 70 Am. St. Rep. 661.

In *Goodwin v. Clayton*, 137 N. C. 224, 49 S. E. 173, 67 L. R. A. 209, 107 Am. St. Rep. 479, a tobacco company obtained a charter in New Jersey for the avowed purpose of establishing its office and transacting its business in North Carolina. The

court said: "It was born, it is true, in New Jersey, but it lives, moves and has its being in this state. It is nominally a corporation of the other state, where it was originally created, but in reality has its home, its domicile, here." Citing *Murfree, Foreign Corporations*, secs. 8, 9.

⁹ 13 Pet. (U. S.) 519, 10 L. Ed. 274. "A corporation can have no legal existence out of the boundaries of the sovereignty by which it is created; it must dwell in the place of its creation and cannot migrate to another sovereignty."

Doctrine of comity.—From the fact that a corporation may have the power or capacity to act in another state or country than that by which it was created, it does not follow that it has the right to do so whether the other state or country consents or not. On the contrary, it is thoroughly well settled, except as will be hereafter shown, that a corporation created by one state or country cannot act in another state or country without the latter's consent, express or implied. If no constitutional provision is violated, a state, as we shall presently see, may exclude a foreign corporation altogether, and refuse to recognize it at all, or it may impose any terms or conditions it may see fit on allowing it to do business within its limits.¹⁰

In the absence of an express statutory prohibition, the right of a corporation created by one state to do business in another is recognized by what is known as comity between states. By comity among nations, which prevails also as between the states, a corporation created by the laws of one state or country is permitted to do business and make contracts in another state or country, and to sue in its courts, unless there is some express statutory prohibition, or unless the recognition of the corporation by such other state or country is contrary to its public policy, as established by the general course of its legislation or the adjudications of its courts.¹¹ Morawetz says:¹² "The law of comity by which corporations of a foreign state are recognized and permitted to transact their affairs is founded on reasons of convenience. Its purpose is to enable each state to charter corporations for legitimate objects, with the power to extend their dealings into other states, in the same manner as individuals engaged in a similar trade or enterprise. But it was not established for the purpose of giving any state an unlimited power to dispose of the franchise of acting in a corporate capacity in other states."

¹⁰ Post, § 286; *Pierce Oil Corp. v. Phoenix Refining Co.*, 259 U. S. 125, 66 L. Ed. 885, 42 Sup. Ct. 440; *American Uniform Co. v. Commonwealth*, 237 Mass. 42, 129 N. E. 622.

¹¹ *Bank of Augusta v. Earle*, 13 Pet. (U. S.) 519, 10 L. Ed. 274; *Cowell v. Colorado Springs Co.*, 100 U. S. 55, 25 L. Ed. 547; *American & Foreign Christian Union v. Yount*, 101 U. S. 352, 25 L. Ed. 888; *Waters-Pierce Oil Co. v. Texas*, 177 U. S. 28, 44 L. Ed. 657, 20 Sup. Ct. 518; *Lancaster v. Amsterdam Improvement*

Co., 140 N. Y. 576, 35 N. E. 964, 24 L. R. A. 322, rev'g 72 Hun 18, 25 N. Y. Supp. 309; *Oakdale Mfg. Co. v. Garst*, 18 R. I. 484, 49 Am. St. Rep. 784; *Paul v. Virginia*, 8 Wall. (U. S.) 168, 19 L. Ed. 357; *Pembina Consol. Silver Mining & Milling Co. v. Pennsylvania*, 125 U. S. 181, 31 L. Ed. 650, 8 Sup. Ct. 737; *People v. Woman's Home Missionary Soc. of M. E. Church*, 303 Ill. 418, 135 N. E. 749.

¹² 2 Morawetz, *Corporations*, sec. 965a.

A grant of corporate existence is a grant of special privilege or capacity. One state cannot confer a franchise or privilege of acting in a corporate capacity which must be recognized by another state. But it is a general rule of the common law that corporations chartered by other states may carry on business, make contracts, hold property and may sue in a state, unless forbidden by statute. This rule of law is said to exist by "comity" among the states, which means no more than that a state is not obliged to recognize the right of the foreign corporation so to act.¹³ The privilege of suing, of making and enforcing contracts, of acquiring property and transacting business will be recognized, provided it is not expressly prohibited by statute. A policy of the state not to permit foreign corporations to do business or acquire land must be expressed affirmatively. It is not inferable from the fact that the legislature has made no provision for similar corporations.^{13a}

Comity between states, however, does not require a state to allow a foreign corporation to do business or hold property within its limits, or require the courts to enforce its contracts made within the state, or otherwise recognize it, when to do so would either violate an express provision of the constitution or laws of the state, or be contrary to the principles of its common law, or contrary to its public policy as established or shown by the general course of its legislation, or by the adjudications of its courts.¹⁴ It has been held, therefore, that a foreign corporation will not be allowed to come into a state and exercise powers which, although conferred upon it by its charter, are denied by the laws or public policy of the state to its own corporations, and, if it attempts to do so, the courts must refuse to recognize it, or to enforce its contracts.¹⁵

¹³ Paul v. Virginia, 8 Wall. (U. S.) 168, 181, 19 L. Ed. 357: "Now a grant of corporate existence is a grant of special privileges to the corporations, enabling them to act for certain designated purposes as a single individual, and exempting them (unless otherwise specially provided) from individual liability. . . . The recognition of its existence even by other states, and the enforcement of its contract made therein, depend purely upon the comity of those states." Assent to enjoyment of the corporate privilege may be granted upon any terms and conditions.

^{13a} Commonwealth Acceptance Corp.

v. Jordan, 198 Cal. 618, 246 Pac. 796.

¹⁴ Blake v. McClung, 172 U. S. 239, 43 L. Ed. 432, 19 Sup. Ct. 165; Paul v. Virginia, 8 Wall. (U. S.) 168, 19 L. Ed. 357; H. K. Mulford Co. v. Curry, 163 Cal. 276, 125 Pac. 236.

¹⁵ Consolidated Rendering Co. v. Vermont, 207 U. S. 541, 52 L. Ed. 327, 28 Sup. Ct. 178, 12 Ann. Cas. 658; Clarke v. Central Railroad & Banking Co. of Georgia, 50 Fed. 338, 15 L. R. A. 683; American De Forest Wireless Tel. Co. v. Superior Court of City and County of San Francisco, 153 Cal. 533, 96 Pac. 15, 17 L. R. A. (N. S.) 1117, 126 Am. St. Rep. 125; People v. Howard, 50 Mich. 239, 15

Comity does not allow one state to create and send forth corporations into other states to do business there, when the state creating them will not allow them to do business within its own boundaries. Where a corporation, therefore, was created by the laws of Pennsylvania, and its charter provided that it might do business anywhere "except in the state of Pennsylvania," it was held by the Kansas court that it could not do business in that state.¹⁶ Nor does the comity between states require the courts of a state to recognize as valid a corporation formed by its citizens in another state, either in evasion or fraud of its own laws, or in fraud of the laws of the other state.¹⁷ Whether such a step is a fraud upon the laws of either state depends upon the circumstances. The mere fact that the citizens of a state go into another state and form a corporation, under its laws, for the purpose of doing business as a foreign corporation in the state in which they reside, instead of incorporating under the laws of the latter state, does not of itself render the incorporation a fraud upon or evasion of the laws of either state, and is no ground for refusal to recognize the corporation and allow it to do business, like any other foreign corporation, in the state in which the corporators reside.¹⁸

§ 286. Conditions upon the right of foreign corporations to do business.

It is well settled that a state may exclude a foreign corporation altogether from doing business or acquiring property with its

N. W. 101; *United States Mortg. Co. v. Gross*, 93 Ill. 483; *Fowler v. Bell*, 90 Tex. 150, 37 S. W. 1058, 39 L. R. A. 254, 59 Am. St. Rep. 788; *Falls v. United States Savings, Loan & Building Co.*, 97 Ala. 417, 13 So. 25, 24 L. R. A. 174, 38 Am. St. Rep. 194.

A foreign corporation is not to be excluded merely because it is capitalized with stock without par value, although the particular state does not authorize such stock. *North American Petroleum Co. v. Hopkins*, 105 Kan. 161, 181 Pac. 625; *State ex rel. Standard Tank Car Co. v. Sullivan*, 282 Mo. 261, 221 S. W. 728. See note, 19 A. L. R. 131.

¹⁶ *Land Grant Railway & Trust Co. v. Coffey County Com'rs*, 6 Kan. 245; *Myatt v. Ponca City Land & Improvement Co.*, 14 Okla. 189, 78 Pac. 185, 68 L. R. A. 810. But see *Scharbauer v. Lampasas County*, — Tex. Civ.

App. —, 214 S. W. 468; *Troy & North Carolina Gold Min. Co. v. Snow Lumber Co.*, 173 N. C. 593, 92 S. E. 494, L. R. A. 1917 E 892 on status of foreign corporation as affected by fact that its entire business is done outside the state of its creation.

¹⁷ *United States Vinegar Co. v. Schlegel*, 143 N. Y. 537, 38 N. E. 729; *Demarest v. Flack*, 128 N. Y. 205, 28 N. E. 645, 13 L. R. A. 854; *Merrick v. Brainard*, 38 Barb. (N. Y.) 574; *Hill v. Beach*, 12 N. J. Eq. 31; *Empire Mills v. Alston Grocery Co.* (Tex.), 4 Willson Civ. Cas. Ct. App. § 221, 15 S. W. 200, 505, 12 L. R. A. 366.

¹⁸ *Demarest v. Flack*, 128 N. Y. 205, 28 N. E. 645, 13 L. R. A. 854; *Lancaster v. Amsterdam Improvement Co.*, 140 N. Y. 576, 35 N. E. 493, 24 L. R. A. 322; *Oakdale Mfg. Co. v. Garst*, 18 R. I. 484, 28 Atl. 973, 23

limits, or it may impose any conditions or restrictions which it may see fit to impose, provided it does not thereby violate any provision of its own constitution or of the Constitution of the United States. The law of comity merely enables the corporation to exercise the privilege of acting in a corporate capacity in foreign states. There is nothing in the Constitution of the United States limiting the power of the several states to repeal the common law rule of comity by which foreign corporations are recognized and permitted to act in a corporate capacity. A state may wholly exclude corporations chartered by other states or may require them to comply with certain prescribed formalities as a condition to the right of transacting business.¹⁹ Statutes frequently require foreign corporations as a condition of doing business, to register by filing a copy of their articles of incorporation with the secretary of state, to pay license fees, to appoint an agent on whom process may be served, to designate and maintain an office in the state, to take out a license or permit of authority to do business, to keep books and records in the state, to deposit securities with some official for the protection of those who do business with the corporation.²⁰ Failure to comply with these conditions may prevent the corporation from commencing or maintaining actions; may subject the corporation and its officers or agents to penalties; and may make stockholders or officers personally liable for debts contracted in the state in violation of the statute.

L. R. A. 639, 49 Am. St. Rep. 784; *State v. Topeka Water Co.*, 61 Kan. 547, 60 Pac. 337. Compare however, *Hill v. Beach*, 12 N. J. Eq. 31.

¹⁹ Morawetz, *Corporations*, secs. 359, 959; *Cowell v. Colorado Springs Co.*, 100 U. S. 55, 25 L. Ed. 547, 70 L. R. A. 520n; *Paul v. Virginia*, 8 Wall. (U. S.) 168, 19 L. Ed. 357 (recognition of foreign corporation and enforcement of its contracts in other states rests only on comity, and any conditions may be imposed or it may be entirely excluded); *Interstate Amusement Co. v. Albert*, 239 U. S. 560, 568, 60 L. Ed. 439, 443, 36 Sup. Ct. 168, 170; *Hooper v. California*, 155 U. S. 648, 39 L. Ed. 297, 15 Sup. Ct. 207.

²⁰ In *McIntosh Livestock Co. v. Buffington*, 116 Ore. 399, 241 Pac. 393, it is said: "Before transacting business in this state, a foreign cor-

poration must: (1) File its declaration reciting certain things as provided in section 6909, Or. L., as amended by General Laws of Oregon for 1923, c. 244; (2) pay license fee; (3) execute and acknowledge power of attorney and record same in the office of the corporation commissioner; and (4) accompany the declaration with a certified copy of the articles of incorporation. When the corporation commissioner is satisfied that there has been a substantial compliance with the statute in the above particulars, he is authorized to issue a certificate, which, by virtue of section 6910, as amended by chapter 244, General Laws of Oregon for 1923, is *prima facie* evidence of the legal existence of such foreign corporation and of its right to transact business in Oregon." See 25 *Columbia Law Rev.* 1040.

In accordance with this doctrine, it is well settled that a state may require a foreign insurance company or other corporation, as a condition of the right to do business and make contracts within the state, to pay a certain license fee or tax, although no such fee or tax, or a less one, may be exacted from its own corporations engaged in the same business, provided it does not thereby violate any constitutional prohibition.²¹ It may require a foreign insurance company or other corporation to make a deposit or furnish other security for the protection of persons who may deal with it, and to whom it may become indebted,²² and may further provide that the money or securities so deposited shall constitute a trust fund for the benefit of its resident creditors.²³ It may also require it to maintain a known place of business within the state, and an agent residing there, with authority to accept and receive service of process, and to file a certificate in the office of the secretary of state, or some other office, designating such place of business and agent.²⁴

Retaliatory statutes.—In a number of states the legislatures have enacted statutes of a retaliatory nature for the purpose of putting foreign corporations under the same restrictions and burdens as are imposed by the states by which they were created upon corporations of the state enacting the statute.²⁵ Such a statute is not unconstitutional, either on the ground that it denies to persons within the jurisdiction of the state the equal protection of its laws, or because it violates the requirement of equality and uniformity in taxation, or, by the weight of authority, on the ground that it is, in effect, not itself the exercise of legislative power, but a delega-

²¹ *Paul v. Virginia*, 8 Wall. (U. S.) 168, 19 L. Ed. 357; *American Smelting & Refining Co. v. Colorado ex rel. Lindsley*, 204 U. S. 103, 51 L. Ed. 393, 27 Sup. Ct. 198, 9 Ann. Cas. 978; *Wm. A. Slater Mills v. Gilpatric*, 97 Conn. 521, 117 Atl. 806.

²² *Paul v. Virginia*, 8 Wall. (U. S.) 168, 19 L. Ed. 357; *Phenix Ins. Co. v. Burdett*, 112 Ind. 204, 13 N. E. 705; *People v. Granite State Provident Ass'n*, 41 N. Y. App. Div. 257, 58 N. Y. Supp. 510, *aff'd* 161 N. Y. 492, 55 N. E. 1053; *Phillips v. Perue*, 111 Tex. 112, 229 S. W. 849, *aff'd* — Tex. Civ. App. —, 233 S. W. 152.

²³ *People v. Granite State Provident Ass'n*, 41 N. Y. App. Div. 257, 58 N.

Y. Supp. 510, *aff'd* 161 N. Y. 492, 55 N. E. 1053. Compare post, § 287.

²⁴ *Hagler v. Security Mut. Life Ins. Co.*, 244 Fed. 863; *St. Clair v. Cox*, 106 U. S. 350, 356, 27 L. Ed. 222, 1 Sup. Ct. 354; *American U. Tel. Co. v. Western U. Tel. Co.*, 67 Ala. 26, 42 Am. Rep. 90; *Dudley v. Collier*, 87 Ala. 431, 6 So. 304, 13 Am. St. Rep. 55; *Carr v. Aetna Accident & Liability Co.*, 263 Pa. 87, 106 Atl. 107.

²⁵ *Lehigh Structural Steel Co. v. Atlantic Smelting & Refining Works*, 92 N. J. Eq. 131, 111 Atl. 376; *Wabash R. Co. v. Fox*, 64 Ohio St. 133, 59 N. E. 888, 83 Am. St. Rep. 739.

tion of the legislative power of the state to other states.²⁶ It has been held that these statutes are penal in their character, and are therefore to be strictly construed.²⁷

§ 287. Constitutional limitations on power to exclude foreign corporations or impose conditions.

The power of a state to exclude foreign corporations, or to impose conditions upon their right to do business within its limits, and to sue in its courts, or to impose taxes, etc., is subject, of course, to any limitations which may be found in the constitution of the state, or in the Constitution and law of the United States, and any statute which is in contravention of either is void.²⁸

Prohibition against denying to the citizens of any state the privileges and immunities of citizens in the several states.—It is thoroughly well settled, however, that a state is not prevented from excluding foreign corporations from doing business or holding property within its limits, or from imposing conditions in permitting them to do so, by the provision of the Federal Constitution that the citizens of each state shall be entitled to all the privileges and immunities of citizens in the several states, for this provision does not entitle a corporation created by one state to exercise its special privileges in other states without their consent. "The

²⁶ *People v. Fire Ass'n of Philadelphia*, 92 N. Y. 311, 44 Am. Rep. 380; *Philadelphia Fire Ass'n v. New York*, 119 U. S. 110, 30 L. Ed. 342, 7 Sup. Ct. 108; *Phoenix Ins. Co. v. Welch*, 29 Kan. 672; *Talbott v. Fidelity & Casualty Co.*, 74 Md. 536, 22 Atl. 395, 13 L. R. A. 584; *Home Ins. Co. v. Swigert*, 104 Ill. 653; *State ex rel. Baldwin v. Insurance Co. of North America*, 115 Ind. 257, 17 N. E. 574; *Clay v. Dixie Fire Ins. Co.*, 168 Ky. 315, 181 S. W. 1123.

²⁷ *State v. Fidelity & Casualty Ins. Co. of N. Y.*, 49 Ohio St. 440, 31 N. E. 658, 16 L. R. A. 611, 34 Am. St. Rep. 573; *Griesa v. Massachusetts Ben. Ass'n*, 60 Hun 581, 15 N. Y. Supp. 71, aff'd 133 N. Y. 619, 30 N. E. 1146; *State v. Fidelity & Casualty Ins. Co.*, 39 Minn. 538, 31 N. W. 108. See *Metropolitan Life Ins. Co. v. Boys*, 296 Ill. 166, 123 N. E. 724.

²⁸ *H. K. Mulford Co. v. Curry*, 163 Cal. 276, 125 Pac. 236, 239. See *Unconstitutional conditions*, 15 Califor-

nia Law Rev. 316; 25 *Michigan Law Rev.* 777.

Henderson finds an evolution from an extreme restrictive theory to a doctrine of greater and greater recognition, according foreign corporations a position of equality with domestic. See *Position of Foreign Corporations in American Constitutional Law*, pp. 7, 111; *The Changing Law of Foreign Corporations*, T. R. Powell, 33 *Political Science Quarterly* 549; Bowman, *State's Power over Foreign Corporations*, 9 *Michigan Law Rev.* 549; *The Federal Protection of Foreign Corporations*, E. Isaacs, 26 *Columbia Law Rev.* 263: "The development of this protection (from adverse state legislation) is based on a recognition of the fact that foreign corporations are not the hostile creation of an extra-territorial law, an idea still retained by the states, but are simply an instrumentality of modern business."

privileges and immunities," said Mr. Justice Field, "secured to citizens in the latter states under their Constitution and laws by tion, are those privileges and immunities which are common to the citizens in the latter states under their constitution and laws by virtue of their being citizens. Special privileges enjoyed by citizens in their own states are not secured in other states by this provision. It was not intended by the provision to give to the laws of one state any operation in other states. They can have no such operation, except by the permission, express or implied, of those states. The special privileges which they confer must, therefore, be enjoyed at home, unless the assent of other states to their enjoyment therein be given."²⁹

Discrimination against nonresident creditors.—This provision, however, prevents a state, on admitting a foreign corporation and allowing it to acquire property and do business within its limits, from providing, as one of the conditions, that the creditors of the corporation who may be residents of the state shall have priority over nonresident creditors in the distribution of its assets by the courts of the state.³⁰ But it does not prevent the state from requiring a foreign corporation to make a deposit in the state in trust for the benefit and security of resident creditors. In a New York case it was held that the Banking and Insurance Law of that state, requiring a foreign corporation desiring to transact business in the state to deposit a certain amount of money or securities, and providing that, on the appointment of a receiver for the corporation in the state, the deposit shall be paid to him, to be distributed among the resident creditors and shareholders, creates a trust in such fund in favor of resident creditors and shareholders; and that the statute does not violate the federal constitutional provision granting the citizens of each state all the

²⁹ *Paul v. Virginia*, 8 Wall. (U. S.) 168, 19 L. Ed. 357. See also, *Ducat v. Chicago*, 10 Wall. (U. S.) 410, 19 L. Ed. 972; *Pembina Consol. Silver Mining & Milling Co. v. Pennsylvania*, 125 U. S. 181, 31 L. Ed. 65, 8 Sup. Ct. 737; *Norfolk & Western R. Co. v. Pennsylvania*, 136 U. S. 114, 34 L. Ed. 394, 10 Sup. Ct. 958; *Blake v. McClung*, 172 U. S. 239, 43 L. Ed. 432, 19 Sup. Ct. 165; *Mt. Vernon-Woodberry Cotton Duck Co. v. Alabama Interstate Power Co.*, 240 U. S. 30, 60 L. Ed. 507, 36 Sup. Ct. 234.

But see *Henderson*, *Position of Foreign Corporations in American Constitutional Law*, pp. 64, 186, 187.

³⁰ *Blake v. McClung*, 172 U. S. 239, 43 L. Ed. 432, 19 Sup. Ct. 165; s. c., 176 U. S. 59, 44 L. Ed. 371, 20 Sup. Ct. 307. Compare *Sully v. American Nat. Bank*, 178 U. S. 289, 44 L. Ed. 1072, 20 Sup. Ct. 935. See also, *McClung v. Embreeville Freehold, Land, Iron & Railway Co.*, 103 Tenn. 399, 52 S. W. 1001; *Wilson v. Keels*, 54 S. C. 545, 32 S. E. 307, 71 Am. St. Rep. 816.

privileges and immunities of citizens in the several states, since the corporation, by accepting the conditions of the statute, consents to its terms, including the creation of the trust.³¹

Prohibition against denying to any person the equal protection of the laws.—The provision of the Fourteenth Amendment to the Federal Constitution that no state shall deny to any person within its jurisdiction the equal protection of its laws does not prevent a state from excluding foreign corporations altogether, or from imposing any conditions it may see fit before allowing them to come into the state; for a foreign corporation can only be entitled to the benefit of this provision after it has come within the jurisdiction of the state.³² A corporation is a person, however, within the meaning of this provision, and, after a state has admitted a foreign corporation and it has become a person within its jurisdiction, the provision will protect it against arbitrary discrimination.³³

The Supreme Court no longer accepts to the full the old notion that the power to exclude carries with it an absolute power to impose such conditions upon the permission to do business within the state as it may see fit. License taxes on foreign corporations measured by their total capital stock deny due process as well as regulate commerce, because an exertion of authority over property and rights beyond the jurisdiction.³⁴ It may not under the guise of conditions exercise arbitrary powers of control. The power of a state to exclude foreign corporations cannot be used as part of a scheme to accomplish a forbidden result, as to prevent the cor-

³¹ *People v. Granite State Provident Ass'n*, 161 N. Y. 492, 55 N. E. 1053.

³² *National Council v. State Council*, 203 U. S. 151, 51 L. Ed. 132, 27 Sup. Ct. 46; *Pembina Consol. Silver Mining & Milling Co. v. Pennsylvania*, 125 U. S. 181, 31 L. Ed. 650, 8 Sup. Ct. 737; *Philadelphia Fire Ass'n v. New York*, 119 U. S. 110, 30 L. Ed. 342, 7 Sup. Ct. 108; *Blake v. McClung*, 172 U. S. 239, 43 L. Ed. 432, 19 Sup. Ct. 165; *People v. Fire Ass'n of Philadelphia*, 92 N. Y. 311, 44 Am. Rep. 380.

³³ *Southern R. Co. v. Greene*, 216 U. S. 400, 54 L. Ed. 536, 30 Sup. Ct. 287, 17 Ann. Cas. 1247 (a state cannot subject a foreign corporation which has already come into the state and has acquired property of a fixed and permanent nature to a new and

additional franchise tax for the privilege of doing business which is not imposed upon domestic corporations. This would be an unconstitutional denial of equal protection of the laws). See *Bethlehem Motors Corp. v. Flynt*, 256 U. S. 421, 424, 65 L. Ed. 1029, 1031, 41 Sup. Ct. 571; *Bowman*, *State's Power over Foreign Corporations*, 9 Michigan Law Rev. 549, 565.

³⁴ *Western U. Tel. Co. v. Kansas ex rel. Coleman*, 216 U. S. 1, 54 L. Ed. 355, 30 Sup. Ct. 190; *Air-way Elec. Appliance Corp. v. Day*, 266 U. S. 71, 69 L. Ed. 169, 45 Sup. Ct. 12; 30 Yale Law Journal 512; 38 Harvard Law Rev. 361, *Constitutional limits upon franchise taxation of foreign corporations*. See *Hanover Fire Ins. Co. v. Hardinge*, 272 U. S. 494, 47 Sup. Ct. 179, 71 L. Ed. 224; 15 California Law Rev. 316.

poration from resorting to a federal court, or to tax it upon property that by established principles the state has no power to tax, or to interfere with interstate commerce, or to regulate the conduct of the corporation in another jurisdiction beyond any legitimate interest of the state and beyond its legislative power.³⁵

Obligation of contracts—Vested rights.—If a state has permitted a foreign corporation to make contracts or acquire property within its limits, a statute subsequently enacted cannot impair its right to enforce such contracts or deprive it of its right to the property. To give the statute such an operation would render it unconstitutional.³⁶ But the granting of a mere license to a foreign corporation by a state does not create a contract between the state and the corporation, so as to prevent subsequent legislation revoking the license, or imposing new conditions.³⁷ A forfeiture by the state of a license granted to a foreign corporation to do business in the state, for violation by it of the provisions of the statute under which the license was given, and which provides for the forfeiture, does not violate any contract obligation; for if there is any contract obligation, the provision for forfeiture is a part of it.³⁸

Prohibiting the removal of suits into the federal courts.—It is not within the power of a state to prohibit a foreign corporation from removing a suit into the federal courts, as authorized by the acts of congress on the subject.³⁹ A statute, therefore,

³⁵ *Fidelity & Deposit Co. of Maryland v. Tafoya*, 270 U. S. 426, 70 L. Ed. 664, 46 Sup. Ct. 331. See *Palmetto Fire Ins. Co. v. Conn.*, 272 U. S. 295, 47 Sup. Ct. 88, 71 L. Ed. 25; *H. K. Mulford Co. v. Curry*, 163 Cal. 276, 125 Pac. 236; *International Paper Co. v. Massachusetts*, 246 U. S. 135, 141, 62 L. Ed. 624, 38 Sup. Ct. 292, Ann. Cas. 1918 C 617: "A state cannot require the corporation as a condition of the right to do a local business therein, to submit to a tax upon its interstate business or upon property outside the state." See Constitutional limits upon franchise taxation of foreign corporations, 38 Harvard Law Rev. 361.

³⁶ *Louisville & N. R. Co. v. Mottley*, 219 U. S. 467, 55 L. Ed. 297, 31 Sup. Ct. 265, 34 L. R. A. (N. S.) 671; *American Building & Loan Ass'n v.*

Rainbolt, 48 Neb. 434, 67 N. W. 493.

³⁷ *Connecticut Mut. Life Ins. Co. v. Spratley*, 172 U. S. 602, 43 L. Ed. 569, 19 Sup. Ct. 308; *Sandel v. Atlanta Life Ins. Co.*, 53 S. C. 241, 31 S. E. 230. But see *American Can Co. v. Emmerson*, 288 Ill. 289, 123 N. E. 581.

³⁸ *Waters-Pierce Oil Co. v. Texas*, 177 U. S. 28, 44 L. Ed. 657, 20 Sup. Ct. 518.

³⁹ *Home Ins. Co. v. Morse*, 20 Wall. (U. S.) 445, 22 L. Ed. 365; *Terral v. Burke Const. Co.*, 257 U. S. 529, 66 L. Ed. 352, 42 Sup. Ct. 188, 21 A. L. R. 186.

In *Doyle v. Continental Ins. Co.*, 94 U. S. 535, 541, 24 L. Ed. 148, the court said: "A license to a foreign corporation to enter a state does not involve a permanent right to remain." In the *Doyle* case the court reaffirmed

which requires foreign corporations to obtain a permit from a public officer as a condition precedent to the right to do business within the state, and provides that no permit shall be granted unless the agent stipulates not to remove suits into the federal courts, is void, and no action or prosecution can be maintained against an agent of a foreign corporation for violating it.⁴⁰

Interference with interstate or foreign commerce.—Since the Constitution of the United States confers upon congress the exclusive power to regulate commerce with foreign nations, and among the several states, a state cannot exclude a foreign corporation to such an extent as to prevent it from doing business constituting interstate or foreign commerce, or impose a tax or any other condition upon its right to engage in such business.⁴¹ In a leading case,⁴² a corporation, the International Textbook Company, incorporated in Pennsylvania, conducted International Correspondence Schools at Scranton, Pennsylvania. It prepared instruction papers, textbooks and other materials and sent them to students by mail. It employed local agents to secure students and collect tuition. These transactions were parts of its regular busi-

Home Ins. Co. v. Morse, 20 Wall. (U. S.) 445, 22 L. Ed. 365, and held that a state law was not unconstitutional which revoked a license to a foreign corporation to do business within the state because, while doing only a domestic business in the state, it resorted to the federal court sitting in the state; but the Morse case and the Doyle case in so holding have been overruled, and the law is now established in accordance with the views of the minority judges in those cases. Terral v. Burke Const. Co., 257 U. S. 529, 533, 66 L. Ed. 352, 42 Sup. Ct. 188, 21 A. L. R. 186. See Palmetto Fire Ins. Co. v. Beha, 13 Fed. (2d) 500, 509.

⁴⁰ Barron v. Burnside, 121 U. S. 186, 30 L. Ed. 915, 7 Sup. Ct. 931; Terral v. Burke Const. Co., 257 U. S. 529, 66 L. Ed. 352, 42 Sup. Ct. 188, 21 A. L. R. 186.

⁴¹ Pensacola Tel. Co. v. Western U. Tel. Co., 96 U. S. 1, 24 L. Ed. 708; Dahnke-Walker Milling Co. v. Bondurant, 257 U. S. 282, 66 L. Ed. 239, 42 Sup. Ct. 106; International Text-Book Co. v. Pigg, 217 U. S. 91, 54

L. Ed. 678, 30 Sup. Ct. 481, 27 L. R. A. (N. S.) 493, 18 Ann. Cas. 1103.

In H. K. Mulford Co. v. Curry, 163 Cal. 276, 125 Pac. 236, a license or privilege tax for the conduct of intrastate business based upon the total capital or total capital stock of such corporation without just relation to the proportion which that used in the state bears to the whole is unconstitutional and void (a) as being a burden upon interstate commerce, (b) because violation of the 14th amendment as an effort to tax property situated beyond the jurisdiction of the taxing state. See International Lumber Co. v. Emmerson, 311 Ill. 564, 143 N. E. 465.

⁴² International Text-Book Co. v. Pigg, 217 U. S. 91, 54 L. Ed. 678, 30 Sup. Ct. 481, 27 L. R. A. (N. S.) 493, 18 Ann. Cas. 1103, teaching by correspondence and making of contracts relating to transportation of information is interstate commerce. See note 18 Ann. Cas. 1109. A state statute requiring a license as condition of right of foreign corporation to transact interstate business in the state is void as burden on commerce.

ness, continuously conducted in many states, but such business was commerce. A Kansas statute provided that no foreign corporation could do business in Kansas without paying certain fees and filing certain papers with the secretary of state which the Textbook Company had not done. It brought suit in the Kansas courts and was denied a remedy. But the United States Supreme Court held that the state could not prescribe as a condition to the right of the foreign corporation to do interstate business that it should pay fees and file papers with the secretary of state. Such conditions operate as a burden on interstate commerce. A state, therefore, cannot impose a tax or license fee upon a foreign railroad company or express company as a condition of its being permitted to transport persons or goods into the state from a point in another state, or through the state.⁴³

Nor can a state require a foreign telegraph company to pay a tax or license fee, or impose any other terms as a condition of allowing it to transmit messages into or through the state.⁴⁴ Nor can a state deny or impose conditions upon the right of a foreign corporation to ship into the state goods sold by it in another state, or on orders received by traveling salesmen and transmitted to it, or upon the right to maintain an action in the state for the price of goods so sold and shipped.⁴⁵ The fact, however, that a foreign corporation is engaged in interstate commerce does not prevent a state from prohibiting it from doing purely local business, or from imposing a tax or license fee with respect to such business.⁴⁶

⁴³ *St. Louis Southwestern R. Co. v. Arkansas ex rel. Norwood*, 235 U. S. 350, 59 L. Ed. 265, 35 Sup. Ct. 99; *Crutcher v. Kentucky*, 141 U. S. 47, 35 L. Ed. 649, 11 Sup. Ct. 851; *Commonwealth v. Smith*, 92 Ky. 38, 17 S. W. 187, 36 Am. St. Rep. 578.

⁴⁴ *Ludwig v. Western U. Tel. Co.*, 216 U. S. 146, 54 L. Ed. 423, 30 Sup. Ct. 280; *Pensacola Tel. Co. v. Western U. Tel. Co.*, 96 U. S. 1, 24 L. Ed. 708; *Western U. Tel. Co. v. Texas*, 105 U. S. 460, 26 L. Ed. 1067; *Commonwealth v. Smith*, 92 Ky. 38, 17 S. W. 187, 36 Am. St. Rep. 578.

⁴⁵ *Sioux Remedy Co. v. Cope*, 235 U. S. 197, 59 L. Ed. 193, 35 Sup. Ct. 57; *Cooper Mfg. Co. v. Ferguson*, 113 U. S. 727, 28 L. Ed. 1137, 5 Sup. Ct. 739; *Brennan v. City of Titusville*, 153 U. S. 289, 38 L. Ed. 719, 14 Sup. Ct. 829; *York Mfg. Co. v. Colley*, 247 U. S. 21, 62 L. Ed. 963, 38 Sup. Ct. 430, 11 A. L. R. 611, 614n.

A mere incidental agreement to assemble machinery, etc., sold in interstate commerce, does not justify the courts of the state in refusing to enforce payment of the purchase price for failure to secure a permit to do local business. *J. C. Boss Engineering Co. v. Gunderson Brick & Tile Co.*, — Minn. —, 209 N. W. 876.

⁴⁶ *Baltic Min. Co. v. Massachusetts*, 231 U. S. 68, 58 L. Ed. 127, 34 Sup. Ct. 15, it was held that an excise tax imposed on foreign corporation for privilege of doing local business, measured by authorized capital, but limited to specified sum was valid. But in *Alpha Portland Cement Co. v. Massachusetts*, 268 U. S. 203, 218, 69 L. Ed. 916, 45 Sup. Ct. 477, it is held that a state may not burden interstate commerce or tax property beyond her borders under the guise of regulating intrastate business.

Corporations in the employ of the United States government.—The fact that a foreign corporation is in the employ of the United States government does not prevent a state from imposing a tax upon any property which it may own within the state to the same extent as it taxes other property. But a state cannot exclude such a corporation or impose restrictions upon the exercise of its powers within the state as the agent of the federal government.⁴⁷

§ 288. What constitutes doing business within the meaning of the statutes.

In construing and applying statutes prohibiting foreign corporations from "doing business" in a state without first complying with conditions imposed by the statutes, and statutes imposing a tax or license fee upon such corporations, it is sometimes difficult to say whether a particular act or transaction constitutes the doing of business, within the meaning of the statute, and the cases are to some extent conflicting.

A state may assert power over a foreign corporation for one of three main purposes, namely (1) service of process, (2) taxation, or (3) qualification. The basis of the exercise of power is in general the doing of business in the state. The nature and extent of business requisite to make a corporation liable to such power may vary somewhat with the purpose for which it is asserted. There are a number of degrees of doing business, and it is contended by some courts that different degrees are requisite (1) to permit service of process in a suit against a foreign corporation; (2) to subject a corporation to a tax on its business activity; (3) for the application of statutes requiring qualification in the state, i. e., registration, by filing articles, payment of license fees, appointment of agent, depositing securities, etc.⁴⁸

In most jurisdictions it is held that a statute prohibiting a foreign corporation from "doing business" or "doing any business" in the state until it has filed a certificate designating a place of business and a resident agent upon whom process may be served,

⁴⁷ *Pembina Consol. Silver Mining & Milling Co. v. Pennsylvania*, 125 U. S. 181, 186, 31 L. Ed. 650, 8 Sup. Ct. 737; *Sault Ste. Marie v. International Transit Co.*, 234 U. S. 333, 58 L. Ed. 1337, 34 Sup. Ct. 826, 52 L. R. A. (N. S.) 574; *Crescent Cotton Oil Co. v. Mississippi*, 257 U. S. 129, 66 L. Ed. 166, 42 Sup. Ct. 42.

⁴⁸ *Henry M. Day & Co. v. Schiff*,

Lang & Co., 278 Fed. 533; *Beach v. Kerr Turbine Co.*, 243 Fed. 706, 708; *Knutson v. Campbell River Mills*, 300 Fed. 241; *Atkinson v. United States Operating Co.*, 129 Minn. 282, 152 N. W. 410, L. R. A. 1916 E 241; *Tauza v. Susquehanna Coal Co.*, 220 N. Y. 259, 268, 115 N. E. 915; *Isaacs, An Analysis of Doing Business*, 25 *Columbia Law Rev.* 1018, 1024.

or complied with other conditions, contemplates some continuance in business, and does not apply where a foreign corporation does a single act of business within the state, as in the case of a single contract for the sale of goods by a foreign manufacturing or trading company.⁴⁹ Some courts, however, have held that a foreign corporation comes within the statute if it does a single act of its ordinary business within the state. Thus it has been held that a statute prohibiting a foreign corporation from doing business in the state except on compliance with certain conditions, applies where a foreign loan and investment company makes a single loan and takes a mortgage to secure the same.⁵⁰ So where the single act indicates a purpose to continue business in the state, the statute applies.

A statute prohibiting foreign corporations from doing business in the state except upon compliance with certain conditions, or imposing a tax or license fee upon such corporations, has reference to such foreign corporations only as do some part of their ordinary business within the state; and it does not apply to transactions of such a corporation within the state not constituting any part of its ordinary business, nor to transactions outside of the state with persons within the state. Among the contracts and other transactions of foreign corporations which have been held not to constitute the doing of business within a state, within the meaning of such statutes, the following may be mentioned: The purchasing by a foreign trust company of securities of a railway company in the state, and taking a mortgage on its property as security;⁵¹ the

⁴⁹ *Cooper Mfg. Co. v. Ferguson*, 113 U. S. 727, 28 L. Ed. 1137, 5 Sup. Ct. 739; *Caldwell v. North Carolina*, 187 U. S. 622, 47 L. Ed. 336, 23 Sup. Ct. 229; *Delaware & H. Canal Co. v. Mahlenbrock*, 63 N. J. Law 281, 43 Atl. 978, 45 L. R. A. 538; *Commercial Bank of Vancouver v. Sherman*, 28 Ore. 573, 43 Pac. 658, 52 Am. St. Rep. 811.

In the *Cooper Mfg. Co.* case it is said: "The making in Colorado of the one contract sued on in this case, by which one party agreed to build and deliver in Ohio certain machinery and the other party to pay for it, did not constitute carrying on of business in Colorado. . . . To require such a certificate as a prerequisite of doing a single act of business . . . would be unreasonable."

⁵⁰ *Farrior v. New England Mort-*

gage Security Co., 88 Ala. 275, 7 So. 200; *Ginn v. New England Mortg. Security Co.*, 92 Ala. 135, 8 So. 388; *State v. Bristol Sav. Bank*, 108 Ala. 3, 18 So. 533, 54 Am. St. Rep. 131; *Chattanooga Nat. Building & Loan Ass'n v. Denson*, 189 U. S. 408, 47 L. Ed. 870, 23 Sup. Ct. 630. See *John Deere Plow Co. v. Wyland*, 69 Kan. 255, 76 Pac. 863, 2 Ann. Cas. 304; *Artman Lumber Co. v. Bogard*, 191 Ky. 392, 280 S. W. 953.

In Wisconsin a single contract falls within the ban of the statute and is wholly void on its behalf. *Southwestern Slate Co. v. Stephens*, 139 Wis. 616, 626, 120 N. W. 408, 29 L. R. A. (N. S.) 92, 131 Am. St. Rep. 1074.

⁵¹ *Gilchrist v. Helena, H. S. & S. R. Co.*, 47 Fed. 593.

So disposing of stock is held not to be the doing of business so as to

making by a foreign mining corporation of a single purchase of machinery within the state, to be transported to and set up in the state of its domicile;⁵² an action by a foreign corporation on notes taken by it in the state for goods sold by it in the state of its domicile;⁵³ or shipping goods into the state on an order or contract therefor accepted out of the state, or mailed to its office out of the state;⁵⁴ or consigning goods to factors in the state, or to merchants in the state for sale by them on commission;⁵⁵ or soliciting orders in the state by means of nonresident traveling salesmen or other agents, the orders being transmitted to the corporation in the state of its domicile, and the goods shipped from there into the state.⁵⁶ Indeed, if a statute should be construed as applicable to these cases, it would be unconstitutional as an interference with interstate commerce.⁵⁷

warrant service or to require a foreign corporation to qualify. It is incidental, not the usual customary or ordinary business. *Sunrise Lumber Co. v. Homer D. Biery Lumber Co.*, 195 N. Y. App. Div. 170, 185 N. Y. Supp. 711. *Contra, Atkinson v. United States operating Co.*, 129 Minn. 232, 152 N. W. 410.

⁵² *Colorado Iron-Works v. Sieria Grande Min. Co.*, 15 Colo. 499, 25 Pac. 325, 22 Am. St. Rep. 433.

⁵³ *Fuller & Johnson Mfg. Co. v. Foster*, 4 Dak. 329, 30 N. W. 166. See also, *Tallapoosa Lumber Co. v. Holbert*, 5 N. Y. App. Div. 559, 39 N. Y. Supp. 432.

⁵⁴ *Holzer v. Dodge Bros.*, 233 N. Y. 216, 135 N. E. 268; *Gale Mfg. Co. v. Finkelstein*, 22 Tex. Civ. App. 241, 54 S. W. 619; *Spry Lumber Co. v. Chappell*, 184 Ill. 539, 56 N. E. 794; *J. C. Boss Engineering Co. v. Gunderson Brick & Tile Co.*, — Minn. —, 209 N. W. 876. Supervision of installation is incidental to interstate sale and beyond reach of the statute against local business without license.

⁵⁵ *Mitchell Wagon Co. v. Poole*, 235 Fed. 817; *Allen v. Tyson-Jones Buggy Co.*, 91 Tex. 22, 40 S. W. 393, 714; *Eagle Mfg. Co. v. Arkell & Douglas*, 197 N. Y. App. Div. 788, 189 N. Y. Supp. 140.

⁵⁶ *Caldwell v. North Carolina*, 187 U. S. 622, 47 L. Ed. 336, 23 Sup. Ct. 229; *Toledo Commercial Co. v. Glen Mfg. Co.*, 55 Ohio St. 217, 45 N. E. 197; *Cpitt & Co. v. Sutton*, 102 Mich.

324, 60 N. W. 690, 25 L. R. A. 819; *M. I. Wilcox Cordage & Supply Co. v. Mosher*, 114 Mich. 64, 72 N. W. 117; *Wolff-Dryer Co. v. Bigler*, 192 Pa. St. 466, 43 Atl. 1092; *Mearshon & Co. v. Pottsville Lumber Co.*, 187 Pa. St. 12, 40 Atl. 1019, 67 Am. St. Rep. 560; *Droege v. Ahrens & Ott Mfg. Co.*, 163 N. Y. 466, 57 N. E. 747; *Ware v. Hamilton-Brown Shoe Co.*, 92 Ala. 145, 9 So. 136; *Wood & Selick v. American Grocery Co.*, 96 N. J. Law 218, 114 Atl. 756.

See *International Harvester Co. of America v. Kentucky*, 234 U. S. 579, 58 L. Ed. 1479, 34 Sup. Ct. 944. A foreign manufacturing corporation maintained a soliciting office which had authority to take orders for machines and receive payment in money or checks collectible within the state. Corporation was sufficiently present to validate personal service and judgment. But compare *People's Tobacco Co. v. American Tobacco Co.*, 246 U. S. 79, 62 L. Ed. 587, 38 Sup. Ct. 233, Ann. Cas. 1918 C 537; *Holzer v. Dodge Bros.*, 233 N. Y. 216, 135 N. E. 267.

⁵⁷ See the cases above cited. And see ante, § 287.

Dalton Adding Mach. Sales Co. v. Lindquist, 137 Wash. 375, 242 Pac. 643. Sale by agent of foreign corporation made from stock of machines shipped to him within the state, held not to come under protection of interstate commerce rule, although order was taken subject to approval of for-

A statute providing that foreign insurance companies shall comply with certain conditions before they shall be entitled to do business in the state, and that such a company shall not enforce in the courts of the state any contract made by its agents before a compliance with the statute, does not apply, as a rule, to a contract of insurance by a foreign corporation with a resident of the state, and covering property therein, where the contract is made by the company in the state of its domicile, by correspondence or otherwise; and it makes no difference that the premium, either in money or notes, and the application for the insurance, are received by an agent in the state, if no contract is there consummated, but they are forwarded to the company and acted upon, and a policy issued, at its home office.⁵⁸ However, if the contract of insurance is made within the state, it is deemed to be doing business in the state.⁵⁹

§ 289. Effect of failure of foreign corporations to comply with statutes.

There is a conflict of authority as to the effect of failure upon the part of a foreign corporation to comply with a statute imposing conditions upon its right to do business in the state, and it is impossible to reconcile the cases. Of course, the question depends primarily upon the terms of the particular statute, and the intention of the legislature; but even when statutes have been substantially the same, the courts have not agreed in construing them.

eign corporation at home office, citing *Sonneborn Bros. v. Cureton*, 262 U. S. 506, 67 L. Ed. 1095, 43 Sup. Ct. 643.

⁵⁸ In *Palmetto Fire Ins. Co. v. Beha*, 13 Fed. (2d) 500, 507, it is said: "The general rule is that a foreign corporation is not doing business in a state by entering into contracts with residents thereof, where the contracts are made and are to be performed elsewhere, although the contracts relate to property within the state; and where applications for insurance are obtained in a state by an agent of a foreign company, and forwarded by him for acceptance or rejection to a company at a place outside of the state, the company is not doing business in the state where the applicants reside by accepting

and issuing policies in pursuance thereof at such outside office. *Lamb v. Bowser*, 14 Fed. Cas. 980, No. 8009, 7 Biss. 372; *Western v. Genesee Mut. Ins. Co.*, 12 N. Y. 258; *Stone v. Old Colony St. R. Co.*, 212 Mass. 459, 99 N. E. 218; *Clay Fire & Marine Ins. Co. v. Huron Salt & Lumber Mfg. Co.*, 31 Mich. 346; *Connecticut River Mut. Fire Ins. Co. v. Way*, 62 N. H. 622; 32 Cyc. 996."

⁵⁹ *Roche v. Ladd*, 1 Allen (Mass.) 436. See also, *Northwestern Mut. Life Ins. Co. v. Elliott*, 5 Fed. 225; *Hacheny v. Leary*, 12 Ore. 40, 7 Pac. 329; *Cravens v. New York Life Ins. Co.*, 148 Mo. 583, 50 S. W. 519, 53 L. R. A. 305, 71 Am. St. Rep. 628; *Rose v. Kimberly & Clark Co.*, 89 Wis. 545, 62 N. W. 526, 27 L. R. A. 556, 46 Am. St. Rep. 855.

Effect of noncompliance as against the corporation.—When a statute, as is sometimes the case, not only prohibits foreign corporations from doing business in the state without first complying with certain conditions, as the obtaining of a permit, or the filing of a certificate designating a known place of business and an agent upon whom process may be served, etc., but also expressly declares that contracts made without having complied with the conditions shall be void, the effect of a failure to comply with the statute is clear. All contracts within the state, constituting the doing of business, within the meaning of the statute, are absolutely void, and no action can be maintained by the corporation thereon.⁶⁰

Generally, however, the statutes do not expressly declare that contracts made without having complied with the statute shall be void, and in construing such statutes the courts have differed.

Some of the courts have held that where a statute merely prohibits foreign corporations from doing business or taking, holding, and disposing of property in the state until they have complied with conditions precedent imposed by the statute, without declaring that transactions in violation of the statute shall be void, or prescribing any penalty, contracts, conveyances, and other transactions in violation of the statute are not void, but that the only effect is to render the corporation subject to proceedings by the state to oust it from doing business, and that, until the state has proceeded against it, actions may be brought by it on its contracts and to protect its property.⁶¹ Some courts reach the same result by applying the doctrine of estoppel against persons dealing with the corporation.⁶² Such constructions of the statutes, however, are contrary to the weight of authority. Most of the courts hold that the object of the statute is to prohibit foreign corporations, on grounds of public policy, from doing any business in the state

⁶⁰ Phillips Co. v. Everett, 262 Fed. 341 (a Wisconsin corporation could not recover \$32,224, instalments for the installation of automatic fire sprinklers); Loomis v. People's Const. Co., 211 Fed. 453; A. H. Andrews Co. v. Colonial Theatre Co., 283 Fed. 471; Nernst Lamp Co. v. Conrad, 165 Mich. 604, 131 N. W. 120; Hayes Wheel Co. v. American Distributing Co., 257 Fed. 881.

On the enforceability of contracts of unlicensed foreign corporations, see note in 25 Columbia Law Rev. 806.

⁶¹ Boatman's Bank of St. Louis v. Fritzlen, 175 Fed. 183; Garratt Ford

Co. v. Vermont Mfg. Co., 20 R. I. 187, 37 Atl. 948, 38 L. R. A. 545, 78 Am. St. Rep. 852; Washburn Mill Co. v. Bartlett, 3 N. D. 138, 54 N. W. 544; Wright v. Lee, 2 S. D. 596, 51 N. W. 706; s. c., 4 S. D. 237, 55 N. W. 931.

⁶² Sherwood v. Alvis, 83 Ala. 115, 3 So. 781, 3 Am. St. Rep. 695; Washburn Mill Co. v. Bartlett, 3 N. D. 138, 54 N. W. 544; Dearborn Foundry Co. v. Augustine, 5 Wash. 67, 31 Pac. 327; La France Fire Engine Co. v. Town of Mt. Vernon, 9 Wash. 142, 37 Pac. 287, 38 Pac. 80, 43 Am. St. Rep. 827.

until they have complied with all the conditions precedent prescribed by the statute; that this prohibition is absolute, and renders illegal a contract made by a foreign corporation in the state in violation of the statute; that, since the contract is thus illegal, the corporation cannot maintain an action to enforce the same, and that the doctrine of estoppel does not apply.⁶³

Some of the courts have held that, when a statute prohibiting a foreign corporation from doing business in the state without first complying with certain conditions prescribes a specific penalty for violation of the statute, the penalty so prescribed is exclusive, and that contracts made by a foreign corporation without having complied with the statute may be enforced by it.⁶⁴ Other courts have held that the statute, although it imposes a specific penalty, is intended as a prohibition against doing business and making contracts before compliance with the conditions, and that contracts made without such compliance, and in violation of the statute, are none the less illegal and unenforceable by the corporation because the statute imposes a specific penalty for its violation.⁶⁵

Sometimes a statute requiring a foreign corporation to file a certificate, appoint an agent, or comply with other conditions, merely provides, either in express terms or by implication, that a foreign corporation shall not be permitted to maintain suits in the courts until the statute has been complied with. Such a statute does not render void or illegal contracts made in the state by a foreign corporation which has not complied with the conditions, but merely prevents it from suing thereon. It merely suspends the remedy, and, if a corporation complies with the statute after making a contract, it may sue thereon.⁶⁶

Effect of failure to comply with statutes as against persons dealing with corporation.—Statutes prohibiting foreign insur-

⁶³ Pittsburgh Const. Co. v. West Side Belt R. Co., 154 Fed. 929, 11 L. R. A. (N. S.) 1145; Indiana Harbor Belt R. Co. v. Green, 289 Ill. 81, 124 N. E. 298.

⁶⁴ Kraft v. Hoppe, 152 Minn. 143, 188 N. W. 162.

⁶⁵ Montgomery Traction Co. v. Montgomery Light & Water Power Co., 229 Fed. 672; Ryerson & Son v. Shaw, 277 Ill. 524, 115 N. E. 650.

⁶⁶ David Lupton's Sons Co. v. Automobile Club of America, 225 U. S. 489, 56 L. Ed. 1177, 32 Sup. Ct

711, Ann. Cas. 1914 A 699, 702n; Goddard v. Grefield Mills, 75 Fed. 818; Ward Land & Stock Co. v. Mapes, 147 Cal. 747, 82 Pac. 426; Security Savings & Loan Ass'n v. Elbert, 153 Ind. 198, 54 N. E. 753; Elston v. Piggott, 94 Ind. 14; National Mut. Fire Ins. Co. v. Pursell, 10 Allen (Mass.) 231; Carson-Rand Co. v. Stern, 129 Mo. 381, 31 S. W. 772, 32 L. R. A. 420; Neuchatel Asphalt Co. v. City of New York, 155 N. Y. 373, 49 N. E. 1043.

ance companies and other corporations from doing business in the state until they have made a deposit of securities, or performed other conditions, are clearly intended for the protection of the citizens of the state who may deal with such corporations, and, if they do not in terms contain any prohibition against dealing with corporations which have not performed the conditions, they are not to be construed as preventing a citizen who has contracted with a foreign corporation from maintaining an action against it on the contract. To hold otherwise would make the statute an instrument of fraud against those whom it is intended to protect.⁶⁷ Aside from this principle, a foreign corporation, if it does business in a state and enters into contracts without having complied with the conditions imposed by statute, will be estopped to set up its noncompliance with the statute for the purpose of escaping liability on its contracts. It cannot thus take advantage of its own wrong.⁶⁸

Executed contracts.—If a contract by a foreign corporation which was illegal because the corporation had failed to comply with the conditions precedent to the right to do business, or because it was prohibited altogether from doing business, has been fully executed, the courts will not relieve either party from the effect of the contract.⁶⁹

Curative statutes.—When a foreign corporation has unlawfully engaged in business in a state, and made contracts, without complying with statutory requirements, the legislature may waive and cure the illegality by statute, and render the contracts valid. Such a curative statute is not unconstitutional.⁷⁰

⁶⁷ Pennypacker v. Capital Ins. Co., 80 Iowa 56, 45 N. W. 408, 8 L. R. A. 236, 20 Am. St. Rep. 395; Union Mut. Life Ins. Co. v. McMillen, 24 Ohio St. 67; Diamond Plate Glass Co. v. Minneapolis Mut. Fire Ins. Co., 55 Fed. 27; Watertown Fire Ins. Co. v. Simons, 96 Pa. St. 520; Morgan Bros. v. Dayton Coal & Iron Co., 134 Tenn. 228, 183 S. W. 1019, Ann. Cas. 1917 E 42.

⁶⁸ In re Naylor Mfg. Co., 135 Fed. 206; Berry v. Knights Templars' & Masons' Life Indemnity Co., 46 Fed. 439; Ehrman v. Teutonia Ins. Co., 1 Fed. 471.

⁶⁹ Sherwood v. Alvis, 83 Ala. 115, 3

So. 307, 3 Am. St. Rep. 695; Long v. Georgia Pac. Ry. Co., 91 Ala. 519, 521, 8 So. 706, 24 Am. St. Rep. 931; Shahan v. Tethero, 114 Ala. 404, 21 So. 951. But see Wisconsin Trust Co. v. Munday, 168 Wis. 31, 168 N. W. 393, 169 N. W. 612, aff'd 252 U. S. 499, 64 L. Ed. 684, 40 Sup. Ct. 365 (deeds declared void as to the corporation and its grantees because the corporation had not qualified in Wisconsin before acquiring the property).

⁷⁰ Producers Naval Stores Co. v. McAllister, 278 Fed. 13; Mutual Benefit Life Ins. Co. v. Winne, 20 Mont. 20, 49 Pac. 1118; Gross v.

Personal liability of agents and officers.—It is generally held that the officers and agents who represent an unlicensed foreign corporation do not become personally liable on its contracts in the absence of express provision to that effect.⁷¹ Even if the corporation may not enforce its contracts, the courts are not closed to the persons contracting with the corporation. But some states impose personal liability on the officers and even on the innocent stockholders.⁷²

II. RIGHT OF FOREIGN CORPORATIONS TO SUE, AND LIABILITY TO BE SUED.

§ 290. **Right of foreign corporation to sue.**—A corporation may, by comity, sue in the courts of another state or country than that by which it was created, except in so far as the right to do so may be denied by statute, provided the nature of the corporation, or of the right sought to be enforced, is not such as to render the suit contrary to the public policy of the state or country.

A corporation created by the laws of one state or country has the power to sue at law or in equity in the courts of another state or country, and the same right to do so, under the rule of comity, as a domestic corporation, or as a nonresident natural person, unless it is prevented from doing so by some express statutory provision, or unless it seeks to assert and enforce a claim which is contrary to the established public policy of the state.⁷³ A statute may expressly prohibit a foreign corporation from maintaining suits in the courts of the state until it has filed a copy of its charter or

United States Mortg. Co., 108 U. S. 477, 27 L. Ed. 795, 2 Sup. Ct. 940, aff'g 93 Ill. 483.

⁷¹ *Martin Bros. v. Nettleton*, 138 Wash. 102, 244 Pac. 386; *American Soap Co. v. Bogue*, 20 Ohio App. 375, 152 N. E. 393. Failure of a foreign corporation to secure certificate or license authorizing it to transact business in Ohio held not to make its officers personally liable as partners for its debts, as statute prescribes no such penalty. Contracts of foreign corporations are valid, though recourse to the courts is denied until a certificate of compliance with the Ohio laws has been procured.

⁷² *Cunningham v. Shelby*, 136 Tenn. 176, 188 S. W. 1147, L. R. A. 1917 B 572; *Equitable Trust Co. v. Central Trust Co.*, 145 Tenn. 148, 239 S. W.

171; *Joseph T. Ryerson & Son v. Shaw*, 277 Ill. 524, 115 N. E. 650; 27 Yale Law Journal 248, note on Individual liability of officers of a noncomplying foreign corporation.

⁷³ *Meaker Galvanizing Co. v. Charles E. McInnes Co.*, 272 Pa. 561, 116 Atl. 400; *Anglo-American Provision Co. v. Davis Provision Co.*, No. 1, 191 U. S. 373, 48 L. Ed. 225, 24 Sup. Ct. 92; *Henriques v. Dutch West India Co.*, 2 Ld. Raym. 1532; *Bank of Augusta v. Earle*, 13 Pet. (U. S.) 519, 10 L. Ed. 274; *Mandel v. Swan Land & Cattle Co.*, 154 Ill. 177, 40 N. E. 462, 27 L. R. A. 313, 45 Am. St. Rep. 124; *American De Forest Wireless Tel. Co. v. Superior Court of City and County of San Francisco*, 153 Cal. 533, 96 Pac. 15, 17 L. R. A. (N. S.) 1117, 126 Am. St. Rep. 125.

performed other conditions precedent.⁷⁴ Such statutes, however, are rare. Generally, the statutes are directed against "doing business" or "doing any business" in the state, and they apply only when a foreign corporation does some part of its ordinary business in the state. The mere prosecuting or defending of suits by a foreign corporation is not doing business, within the meaning of such a statute, and a foreign corporation, therefore, may sue and defend without having complied with the conditions, or being licensed.⁷⁵

§ 291. Liability of foreign corporations to be sued.—A corporation may be served with process in another state or country, and a personal judgment recovered against it, if it is doing business in such a manner and to such an extent that it is deemed fair and reasonable to make the corporation subject to suit there. This is sometimes expressed in terms of express or implied consent to service, and sometimes in terms of "actual presence."

If the corporation is not doing business in the state, jurisdiction cannot be acquired over it by service of process on an officer who may happen to be within the state. The corporation may, however, voluntarily appear in the action.

If a corporation has real or personal property in another state or country than that by which it was created, it may be proceeded against in such other state by attachment of the property, as in the case of any other nonresident, for the proceeding is *in rem*, and it is not necessary that the court shall acquire personal jurisdiction of the corporation.⁷⁶

The theory that a corporation can act outside the state of domicile by agents, while sufficient to justify its suing and contract-

⁷⁴ *Taber v. Interstate Building & Loan Ass'n*, 91 Tex. 92, 40 S. W. 954.

⁷⁵ *American Loan & Trust Co. v. East & West R. Co.*, 37 Fed. 242; *Lane v. Equitable Trust Co. of New York*, 262 Fed. 918; *General Motors Acceptance Corp. v. Lund*, 60 Utah 247, 208 Pac. 502; *Major Creek Lumber Co. v. Johnson*, 99 Ore. 172, 195 Pac. 177; *Alpena Portland Cement Co. v. Jenkins & Reynolds Co.*, 244 Ill. 354, 91 N. E. 480.

⁷⁶ *Pennoyer v. Neff*, 95 U. S. 714, 24 L. Ed. 565; *Stagg v. British Controlled Oil Fields*, 117 N. Y. Misc. 474, 192 N. Y. Supp. 596; *Cahill v. Broadwell Productions, Inc.*, 190 N.

Y. Supp. 225; *Blackstone Mfg. Co. v. Inhabitants of Blackstone*, 13 Gray (Mass.) 488.

In *Wait v. Kern River Mining, Milling & Development Co.*, 157 Cal. 16, 106 Pac. 98, whenever stock constitutes the subject matter of an action, it may be held to be within the state where the corporation resides. That state is ordinarily the state under the laws of which the corporation was created. But it may be the state where all its business is transacted and where all its property is located. Such a foreign corporation is sufficiently a resident to give jurisdiction over its stock as if it were a domestic corporation.

ing, would not be enough to render it liable to service of process. Jurisdiction cannot be acquired over individuals not citizens or residents or served while actually present. Service on an agent of a nonresident principal is not considered service on the principal.⁷⁷ The courts of a state cannot acquire jurisdiction of an action at law or suit in equity against a foreign corporation, so as to render a personal judgment against it, unless the corporation comes within the jurisdiction of the state, so that process may be served upon it, or unless it voluntarily appears and submits to the jurisdiction. If a foreign corporation is *not doing any business in a state*, service of process upon an officer or agent who happens to come into the state, whether on his own business or casually on business for the corporation, is not service upon the corporation, and can give no jurisdiction as against it, for the officer or agent does not represent the corporation in such a case. And by the overwhelming weight of authority, this is true even when a statute authorizes service of process upon the officers or agents of foreign corporations.⁷⁸ It is now established that a statute cannot give the courts jurisdiction over foreign corporations which are not doing business in the state; and that no jurisdiction is acquired over a foreign corporation by service of process on an officer or agent who is in the state in his private capacity, and on his personal business only, even when there is such a statute, unless the corporation has engaged in business in the state, or otherwise expressly or impliedly consented to be bound by such service.⁷⁹

⁷⁷ Flexner v. Farson, 248 U. S. 289, 63 L. Ed. 250, 39 Sup. Ct. 97. See Scott, 32 Harvard Law Rev. 871.

⁷⁸ Riverside & Dan River Cotton Mills v. Menefee, 237 U. S. 189, 59 L. Ed. 910, 35 Sup. Ct. 579; St. Clair v. Cox, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; Goldey v. Morning News of New Haven, 156 U. S. 518, 39 L. Ed. 517, 15 Sup. Ct. 559; Barrow Steamship Co. v. Kane, 170 U. S. 100, 42 L. Ed. 964, 18 Sup. Ct. 526; Eureka Mercantile Co. v. California Ins. Co., 130 Cal. 153, 62 Pac. 393; Midland Pac. Ry. Co. v. McDermid, 91 Ill. 170. See 35 Harvard Law Rev. 87; 32 Harvard Law Rev. 871, 879; 37 Harvard Law Rev. 825; 33 Yale Law Journal 547.

⁷⁹ Riverside & Dan River Cotton Mills v. Menefee, 237 U. S. 189, 59 L. Ed. 910, 35 Sup. Ct. 579; Toledo

Railways & Light Co. v. Hill, 244 U. S. 49, 61 L. Ed. 982, 37 Sup. Ct. 591; St. Clair v. Cox, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; Goldey v. Morning News of New Haven, 156 U. S. 518, 39 L. Ed. 517, 15 Sup. Ct. 559; James Dickinson Farm Mortg. Co. v. Harry, 273 U. S. 119, 71 L. Ed. 362, 47 Sup. Ct. 308.

Huckabee v. Pullman Co., 8 Fed. (2d) 43: "The essentials for suit against a foreign corporation are that it shall be engaged in business in this state and that service must be upon an agent who represents the corporation in its business."

Ticket agents of the railroad company who sold tickets furnished them by the Pullman company were held agents who represented it in its business and on whom service of process might be made in a suit against it.

In the earlier cases in the Supreme Court of the United States, the consent theory of jurisdiction is relied upon. In the later cases, the theory of corporate presence is the formula adopted as the ground for service *in personam* against foreign corporations. In *Bank of America v. Whitney Cent. Nat Bank*, the court said:⁸⁰ "The jurisdiction taken of foreign corporations, in the absence of statutory requirement or express consent, does not rest upon a fiction of constructive presence, like *qui facit per alium facit per se*. It flows from the fact that the corporation itself does business in the state or district in such a manner and to such an extent that its actual presence there is established."

This is hardly to be taken as a new criterion to measure the amount of business which must be transacted by a foreign corporation so as to subject it to the service of process, but simply as a vague and metaphorical formula.⁸¹ This theory of "presence" like the earlier theory of "implied consent" seems a mere fiction or figure of speech. The real basis of jurisdiction is such a course of business activity by corporate agents that it is deemed fair, politic and reasonable to make the corporation subject to suit there. The "presence" test itself calls for a test and no more definite test has been prescribed than that the acts done must constitute some part of the ordinary business of the corporation and must be continuous or of some duration.⁸²

In a recent United States Supreme Court case the issue was considered whether the use of a subsidiary to transact business in a state will subject the parent corporation to the jurisdiction.⁸³ The

⁸⁰ 261 U. S. 171, 67 L. Ed. 594, 43 Sup. Ct. 311. See also, *St. Louis Southwestern Ry. Co. of Texas v. Alexander*, 227 U. S. 218, 57 L. Ed. 486, 33 Sup. Ct. 245, Ann. Cas. 1915 B 77; *International Harvester Co. of America v. Kentucky*, 234 U. S. 579, 58 L. Ed. 1479, 34 Sup. Ct. 944; *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U. S. 333, 69 L. Ed. 634, 45 Sup. Ct. 250; 25 *Columbia Law Rev.* 1018, 1034.

⁸¹ Jurisdiction over foreign corporations, Fead, 24 *Michigan Law Rev.* 633, 60 *Amer. Law Rev.* 481: "A foreign corporation by doing business within a state submits itself to the laws of that state which may reasonably be applied to it." See *Smolik v. Philadelphia & Reading Coal & Iron Co.*, 222 Fed. 148; *Farm-*

ers' & Merchants' Bank of Catlettsburg, Ky. v. Federal Reserve Bank of Cleveland, Ohio, 286 Fed. 566, 571, 572, criticising the "presence" test of jurisdiction. See also, 30 *A. L. R.* 256n; 30 *Harvard Law Rev.* 676; 36 *Yale Law Journal* 882; 21 *Illinois Law Rev.* 813.

⁸² *Farmers' & Merchants' Bank of Catlettsburg, Ky. v. Federal Reserve Bank of Cleveland, Ohio*, 286 Fed. 566, 588; 30 *Harvard Law Rev.* 676; 32 *Harvard Law Rev.* 871, 881; 36 *Harvard Law Rev.* 327; 37 *Harvard Law Rev.* 825, 826; 33 *Yale Law Journal* 547.

⁸³ *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U. S. 333, 69 L. Ed. 634, 45 Sup. Ct. 250. See 20 *Illinois Law Rev.* 281; 14 *California Law Rev.* 12.

Cudahy Packing Company, a Maine corporation, used as an instrumentality to market the Cudahy products within the State of North Carolina, the Cudahy Packing Company of Alabama. Process was served upon the process agent of the Cudahy Company of Alabama and the plaintiff undertook to establish identity between the defendant, the Maine corporation and its subsidiary, the Alabama corporation. The latter bought from the defendant and sold to dealers. Goods packed by the defendant in Iowa were shipped direct to dealers and the Alabama corporation collected the price. Through ownership of the entire capital stock and otherwise the parent corporation dominated the Alabama corporation completely and exerted its control in substantially the same way, and through the same officers, as it did over those selling branches or departments of its business not separately incorporated which were established to market the Cudahy products in other states. But the technical existence of the Alabama Company as a distinct corporate entity was observed. Its organization was separately kept up, and all transactions between the two corporations were represented by entries in their respective books. This corporate separation from the general Cudahy business was evidently adopted because the defendant wished to have business transactions in North Carolina, but did not choose to enter the state in its corporate capacity. It preferred to employ a subsidiary corporation. Was it not carrying on part of its business through the subsidiary company?

The court held that it was already established law that the use of a subsidiary does not necessarily subject a parent corporation to the jurisdiction of the state. The present case, it was said, differs perhaps in degree from previous cases, in that the identity of interest was more complete and the exercise of control over the subsidiary more intimate than in prior cases. The corporate separation, though merely formal, was however, respected for jurisdictional purposes. A subsidiary transacting business in a state, though a mere adjunct or instrumentality of a foreign corporation which owns and controls it, is a separate entity so that the foreign corporation is not doing business there itself. The court distinguishes cases dealing with the matter of jurisdiction over a foreign corporation from other classes of cases where there is an attempt to hold the parent liable for an act or omission of its subsidiary, or to enforce against a subsidiary a liability of the parent. Such cases

are referred to as concerning substantive rights rather than procedure.⁸⁴

It had been held on the other hand by the Texas court that a foreign railway company might be sued in a state and county in which it was doing business through the instrumentality of a domestic corporation which operated a line of railway connecting with the foreign corporation's line. The foreign corporation was considered to be doing business in the state through the local company as its representative, and was liable to suit for personal injury by service of process on the officers of the local company. The principal corporation, it was held, was really represented by the agents of the subsidiary corporation and liable the same as if the business had been done in its name.^{84a} It must, however, now be recognized in all states that an auxiliary company is not to be treated as the representative of the parent company, nor are its agents to be regarded as agents of the parent company for the purpose of service of process, nor is the parent corporation "doing business" through the subsidiary.⁸⁵

A corporation may expressly authorize an officer or agent to accept or receive service of process in other states; or it may do so impliedly by doing business in another state under the authority of a statute providing for service of process upon agents of foreign corporations doing business therein. Such statutes have been enacted in most jurisdictions, if not in all. When a foreign corporation accepts the benefit of such a statute by allowing its agents to do business in a state, it impliedly agrees to its terms, and will

⁸⁴ See ante, § 6.

^{84a} *Buie v. Chicago, R. I. & P. R. Co.*, 95 Tex. 51, 65 S. W. 27, 55 L. R. A. 861; *Central Life Securities Co. v. Smith*, 236 Fed. 170, commented on in 15 Michigan Law Rev. 442; *In re San Antonio Land & Irrigation Co., Ltd.*, 228 Fed. 984; *Colonial Trust Co. v. Montello Brick Works*, 172 Fed. 310; see *R. H. Herron Co. v. West Side Elec. Co.*, 18 Cal. App. 778, 124 Pac. 455. In a later Texas case, however, this doctrine was repudiated in view of the fact that it had been otherwise decided by the United States Supreme Court, which is the final authority upon the question of jurisdiction. See 6 Minnesota Law Rev. 309.

⁸⁵ *Peterson v. Chicago, R. I. & P. R. Co.*, 205 U. S. 364, 51 L. Ed. 841, 27 Sup. Ct. 513; *Proctor & Gamble Co. v. Newton*, 289 Fed. 1013, 1016; *Atchison, T. & S. F. R. Co. v. Stevens*, 109 Tex. 262, 206 S. W. 921; *Pecos & N. T. R. Co. v. Cox*, 106 Tex. 74, 157 S. W. 745. But see *Cutler v. Cutler-Hammer Mfg. Co.*, 266 Fed. 388.

In *People's Tobacco Co. v. American Tobacco Co.*, 246 U. S. 79, 62 L. Ed. 587, 38 Sup. Ct. 233, Ann. Cas. 1918C 537, the doing of business sufficient to subject corporation to service of process must indicate submission and presence. Holding stock in local subsidiary companies, or sending agents to solicit orders not sufficient.

be bound by service of process upon its agent in accordance with the statute.⁸⁶

A foreign corporation by doing business within a state subjects itself to service of process although the business is confined to interstate commerce. The jurisdiction does not depend upon the power to exclude or to impose conditions.⁸⁷

§ 292. Extraterritorial effect of judgments against a foreign corporation.

A judgment recovered against a foreign corporation in an action in which personal jurisdiction of the corporation is obtained, as has just been explained, is not only valid in the state in which it is rendered, but must also be recognized as valid in every other state, and in the federal courts, for it is within the provision of the federal constitution and act of congress requiring full faith and credit to be given in each state to the properly authenticated records and judicial proceedings of other states.⁸⁸ This, however,

⁸⁶ *Mutual Reserve Fund Life Ass'n v. Phelps*, 190 U. S. 147, 47 L. Ed. 987, 23 Sup. Ct. 707; *St. Clair v. Cox*, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; *Barrow Steamship Co. v. Kane*, 170 U. S. 100, 42 L. Ed. 964, 18 Sup. Ct. 526.

May a state statute require that a foreign corporation before doing business in the state shall file a consent that a state official may receive service of process for it in all causes of action regardless of whether they arise out of business done in the state? See 10 *Minnesota Law Rev.* 520, 529. This might be unconstitutional as an attempt to use its power to exclude is a way not required for the protection of the citizens of the state against evasion of duties owed toward them. See 30 *A. L. R.* 255, 258, 280, note, as to service of process upon actual agent of foreign corporation in action based on transactions outside of the state.

On causes of action arising within the states, service may be made on (a) an agent duly consented to; (b) a representative agent; (c) a public official consented to; (d) a public official designated by statute. On causes of action arising out of the state, the rules seem to be the same except as to (d). *Simon v. Southern R. Co.*, 236 U. S. 115, 59 L. Ed. 492,

35 Sup. Ct. 255; *Isaacs*, 25 *Columbia Law Rev.* 1018, 1034; *Scott*, *Fundamentals of Procedure in actions at law*, p. 55; *Scott*, 39 *Harvard Law Rev.* 563, 578; 24 *Michigan Law Rev.* 643-652.

⁸⁷ *Davis v. Farmers' Co-Op. Equity Co.*, 262 U. S. 312, 67 L. Ed. 996, 43 Sup. Ct. 556: "The fact that the business carried on by a corporation is entirely interstate in character does not render the corporation immune from the ordinary process of the courts of a state." But solicitation of traffic by railroads in states remote from their lines cannot be made the basis for service in actions which arose elsewhere.

A foreign corporation doing only an interstate business in the state, which could not have been excluded is nevertheless subject to the service of process under the laws of the state in which it is carrying on business. *International Harvester Co. of America v. Kentucky*, 234 U. S. 579, 58 L. Ed. 1479, 34 Sup. Ct. 944. See 39 *Harvard Law Rev.* 563, 581.

⁸⁸ *Lafayette Ins. Co. v. French*, 18 *How. (U. S.)* 404, 15 L. Ed. 451; *St. Clair v. Cox*, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; *Banco de Sonora v. Morales*, 23 *Ariz.* 248, 203 *Pac.* 328.

does not prevent a foreign corporation from attacking a judgment against it by showing that it is void for want of jurisdiction; and a judgment is void for want of jurisdiction if there was no appearance or submission to the jurisdiction by the corporation, and the service of process was insufficient to bind it. This question was considered in the Supreme Court of the United States, and it was there held that, "when service is made within the state upon an agent of a foreign corporation, it is essential, in order to support the jurisdiction of the court to render a personal judgment, that it should appear somewhere in the record—either in the application for the writ, or accompanying its service, or in the pleadings or the finding of the court—that the corporation was engaged in business in the state. The transaction of business by the corporation in the state, general or special, appearing, a certificate of service by the proper officer on a person who is its agent there would, in our opinion, be sufficient *prima facie* evidence that the agent represented the company in the business. It would then be open, when the record is offered as evidence in another state, to show that the agent stood in no representative character to the company, that his duties were limited to those of a subordinate employee, or to a particular transaction, or that his agency had ceased when the matter in suit arose." ⁸⁹

III. REGULATION OF INTERNAL AFFAIRS OF FOREIGN CORPORATIONS; VISITORIAL POWER.

§ 293. In general.—The courts of a state have no visitorial power over foreign corporations, and cannot regulate or interfere with their internal affairs and management. But they have jurisdiction to enforce individual rights of stockholders, members, or creditors of a foreign corporation, where the enforcement thereof does not involve any regulation of or interference with its internal affairs.

It is a well-settled principle that the courts of a state or country do not assume visitorial power over foreign corporations. Such

⁸⁹ A foreign corporation is amenable to state process only if "doing business" there. *St. Clair v. Cox*, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; 20 Columbia Law Rev. 205. It must appear that it is "doing business within the state in such manner and to such extent as to warrant the inference that it is present there.

And even if it is doing business within the state, the process will be valid only if served upon some authorized agent." *Philadelphia & R. Ry. Co. v. McKibbin*, 243 U. S. 264, 61 L. Ed. 710, 37 Sup. Ct. 280; *Riverside & Dan River Cotton Mills v. Menefee*, 237 U. S. 189, 59 L. Ed. 910, 35 Sup. Ct. 579.

power belongs exclusively to the state or country by which the corporation was created. The courts of a state or country, therefore, will take no jurisdiction to interfere, by injunction or otherwise, in the internal affairs and management of a foreign corporation, even at the suit of a resident stockholder, and even though the corporation may be doing business in the state or country, and may have expressly or impliedly agreed to submit to the jurisdiction of the courts in suits against it.⁹⁰ "The rule rests, according to some decisions, on considerations of policy and propriety rather than of power. . . . deeming it expedient that the matter should be committed to the courts of the domicile." Where the corporation is nonresident only in that it is the creation of another state, its officers, agents, stockholders and property all being within the jurisdiction, policy and expediency do not require the court to deny relief.⁹¹

In accordance with the general rule, it has been held that a court of equity will not, at the suit of a minority stockholder or otherwise, interfere to enjoin the alleged illegal declaration and payment of a stock or other dividend by a foreign corporation;⁹² to compel a foreign corporation to declare and pay a dividend;⁹³ to enjoin a foreign corporation from issuing stock in alleged violation of its charter or the laws of the state of its creation, or to cancel stock so issued by it.⁹⁴ A court of equity clearly has no

⁹⁰ Eberhard v. Northwestern Mut. Life Ins. Co., 210 Fed. 520; Voorhees v. Mason, 245 Ill. 256, 91 N. E. 1056; Boyette v. Preston Motors Corp., 206 Ala. 240, 89 So. 746, 18 A. L. R. 1376, 1383n; Olsen v. Danish Brotherhood in America, 150 Minn. 8, 184 N. W. 178, 18 A. L. R. 1370; Republican Mountain Silver Mines v. Brown, 58 Fed. 644, 24 L. R. A. 776; North State Copper & Gold Min. Co. v. Field, 64 Md. 151, 20 Atl. 1039.

⁹¹ Internal management and administration of foreign corporations, 18 A. L. R. 1383; 32 A. L. R. 1353; 28 Harvard Law Rev. 611.

The Supreme Court of Connecticut, in Low v. R. P. K. Pressed Metal Co., 91 Conn. 91, 99 Atl. 1 (reported in L. R. A. 1917 D 291, with extended notes), said: "It would be an intolerable proposition to assert that any local business was beyond the original equity jurisdiction of our courts, merely because it was con-

ducted by a foreign corporation. The principle that courts will not interfere in what are vaguely called the internal affairs of a foreign corporation must yield to the larger and more important principle that all who choose to engage in business within the state, whether under a corporate franchise or not, necessarily subject such business to the jurisdiction of the courts as fully as if it were conducted by our own citizens or corporations." Quoted and followed in Fudieker v. Louisiana Loan & Investment Co., 13 Fed. (2d) 920. Compare Maguire v. Mortgage Co. of America, 203 Fed. 858.

⁹² Howell v. Chicago & N. W. R. Co., 51 Barb. (N. Y.) 378.

⁹³ Edwards v. Schillinger, 245 Ill. 231, 91 N. E. 1048, 33 L. R. A. (N. S.) 1895, 137 Am. St. Rep. 308.

⁹⁴ Boyette v. Preston Motors Corp., 206 Ala. 240, 89 So. 746, 18 A. L. R. 1376, 1383, 1396, note, Jurisdiction of action involving internal affairs of

jurisdiction whatever to dissolve a foreign corporation.⁹⁵ Nor has it any jurisdiction to appoint a receiver of a foreign corporation, not merely of its assets within the state, but, generally, at the suit either of creditors or of stockholders;⁹⁶ but it has jurisdiction in a proper case, at the suit of a stockholder or creditor, to appoint a receiver of such assets as may be within the state, and to distribute the same in accordance with the equitable rights of the parties,⁹⁷ and it is not prevented from doing so by the fact that a receiver has been appointed for the corporation in the state of its domicile.⁹⁸

§ 294. Rights and liabilities not relating to internal affairs or management of the corporation.

The principle that the courts of a state have no visitorial power over a foreign corporation, and cannot regulate or interfere with its internal affairs and management, does not prevent a court from enforcing individual rights of stockholders or members of a foreign corporation, or from enforcing the rights of creditors with respect to property of the corporation within the state. It was said by the Maryland court in a suit by a stockholder against a foreign corporation: "Where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meetings, or through its agents, the board of directors, that then such action is the management of the internal affairs of the corporation, and in case of a foreign corporation, our courts will not take jurisdiction. Where, however, the act of the foreign

foreign corporation; *Kimball v. St. Louis & S. F. Ry. Co.*, 157 Mass. 7, 31 N. E. 697, 34 Am. St. Rep. 250. But *cp. Guilford v. Western U. Tel. Co.*, 59 Minn. 332, 61 N. W. 324, 50 Am. Rep. 407.

⁹⁵ *Dodge v. Pyrolusite Manganese Co.*, 69 Ga. 665; *Republican Mountain Silver Mines v. Brown*, 58 Fed. 644, 24 L. R. A. 776; *Wilkins v. Thorne*, 60 Md. 253; *Andrews v. Moen*, 162 Mass. 294, 38 N. E. 505; *Raynes v. Sharp*, 238 Mass. 20, 130 N. E. 199. See *Palmer v. Morgan*, 45 App. Cas. (D. C.) 334; *Wallace v. Motor Products Corp.*, 15 Fed. (2d) 211.

⁹⁶ *Maguire v. Mortgage Co. of America*, 203 Fed. 858; *Leary v.*

Columbia River & P. S. Nav. Co., 82 Fed. 777; *Sidway v. Missouri Land & Live-Stock Co., Ltd.*, 101 Fed. 481.

⁹⁷ *Cunliffe v. Consumers' Ass'n of America*, 280 Pa. 263, 124 Atl. 501, 32 A. L. R. 1348; *Day v. Postal Tel. Co.*, 66 Md. 354, 7 Atl. 608; *Holbrook v. Ford*, 153 Ill. 633, 39 N. E. 1091, 27 L. R. A. 324, 46 Am. St. Rep. 917; *Irwin v. Granite State Provident Ass'n*, 56 N. J. Eq. 244, 38 Atl. 680; *Smith v. St. Louis Mut. Life Ins. Co.*, 3 Tenn. Ch. 502; s. c., 6 Lea 564; *Security Savings & Loan Ass'n v. Moore*, 151 Ind. 174, 50 N. E. 869.

⁹⁸ *Holbrook v. Ford*, 153 Ill. 633, 39 N. E. 1091, 27 L. R. A. 324, 46 Am. St. Rep. 917.

corporation complained of affects the complainant's individual rights only, then our courts will take jurisdiction." ⁹⁹

This *dictum*, however, is not strictly accurate. A member or stockholder of a corporation may have individual rights against it solely by reason of his membership, and these rights may be enforced against the corporation in other states than that by which it was created. ¹⁰⁰

In accordance with this view, it has been held that a foreign corporation doing business in a state may be compelled by its courts to issue to a stockholder a new certificate of stock in the place of one which has been destroyed or lost; ¹⁰¹ and that *mandamus* will lie at the suit of a stockholder of a foreign corporation to compel its officers to permit him to inspect the books of the corporation, where the officers reside and the books are kept within the state. ¹⁰²

⁹⁹ North State Copper & Gold Min. Co. v. Field, 64 Md. 151, 154, 20 Atl. 1039.

¹⁰⁰ Guilford v. Western U. Tel. Co., 59 Minn. 332, 341, 61 N. W. 324, 50 Am. St. Rep. 407, 411; Babcock v. Farwell, 245 Ill. 14, 91 N. E. 683, 137 Am. St. Rep. 284, 19 Ann. Cas. 74.

¹⁰¹ Guilford v. Western U. Tel. Co., 59 Minn. 332, 61 N. W. 324, 50 Am. St. Rep. 407.

¹⁰² Richardson v. Swift, 7 Houst. (Del.) 137, 30 Atl. 781, aff'd 7 Houst. (Del.) 338, 6 Atl. 856, 32 Atl. 143, 40 Am. St. Rep. 127. See 18 A. L. R. 1399n.

APPENDIX A

CERTIFICATE OF INCORPORATION OF MODERN MOTOR COMPANY, INC.

THIS IS TO CERTIFY:

FIRST: That we, the subscribers, George S. Newcomer, E. Horry Frost and Douglas H. Rose, the post-office address of all of whom is Calvert Building, No. 101 East Fayette Street, Baltimore, Maryland, all being of full legal age, do, under and by virtue of the General Laws of the State of Maryland, authorizing the formation of corporations, associate ourselves with the intention of forming a corporation.

SECOND: The name of the corporation (which is hereinafter termed the Corporation) is

MODERN MOTOR COMPANY, INC.

THIRD: The purposes for which, and for any of which, the Corporation is formed, and the business and objects to be carried on or promoted by it, are as follows:

1. To purchase and acquire all or any part of the business, properties, real and personal, assets and rights of the Old Reliable Motor Company, a Michigan corporation, including the good will of said business and the exclusive right to use the name "Old Reliable," as applied to automobiles, trucks, parts and appliances in the carrying on of said business; to carry on the business so acquired as a going concern; to pay for the business, properties, assets and rights so purchased and acquired in cash and/or in stock, bonds, debentures, convertible securities and/or other obligations of the Corporation in any manner permitted by law; and to assume or guarantee indebtedness, contracts and commitments of such corporation; also to so purchase and acquire as a going concern or otherwise and to carry on, maintain and operate all or any part of the property or business of any person, firm, association or corporation whatsoever deemed to be of benefit to the Cor-

poration or of use in any manner in connection with any of its objects or purposes.

2. To manufacture, acquire, sell, dispose of and deal in automobiles, motor trucks, cars, boats, tractors, motorcycles and other vehicles, aeroplanes and airships, engines, chassis, bodies, parts, appliances, accessories, equipment, materials and supplies of all kinds, merchandise and any articles of commerce whatsoever.

3. To acquire, own, lease, mortgage, convey or assign in trust, occupy, use, develop, deal in or with, sell or otherwise dispose of real estate, including lands containing any mineral or chemical material whatsoever and any other lands; and to mine or otherwise extract and remove coal, ores, oil, minerals and/or timber from any lands acquired, owned, leased or occupied by the Corporation or from any other lands.

4. To construct, purchase, lease or otherwise acquire, own, operate, improve, mortgage, convey or assign in trust, pledge, convey, sell or otherwise dispose of, and deal in or with plants, factories, buildings, machinery, tools, ships, equipment, railroads, docks, slips, elevators and other means of production, manufacture, transportation and distribution.

5. To buy, sell or otherwise acquire, dispose of, deal in or with, import and export raw materials and supplies of all kinds, automobiles, motor trucks, cars, boats, tractors, motorcycles and other vehicles, aeroplanes and airships, engines, chassis, bodies, parts, appliances, accessories, equipment and all other materials, stock in trade, merchandise and any articles of commerce whatsoever.

6. To engage in any other manufacturing, mining, construction, production, refining or merchandising business of any kind or character whatsoever, and to that end to acquire and own, hold and dispose of any and all property of any nature.

7. To apply for, register, purchase and lease or otherwise acquire, hold, own, use, operate, introduce, develop or control, sell, assign or otherwise dispose of, take or grant licenses or other rights with respect to, and in any and all ways to exploit or turn to account inventions, improvements, copyrights, patents, trade-marks, formulae, trade names and distinctive marks and similar rights of any and all kinds, and whether granted, registered or established by or under the laws of the United States or of any State thereof, or of any other country or place.

8. To purchase or otherwise acquire, obtain an interest in, hold, pledge, mortgage, sell, exchange or otherwise dispose of stocks, voting trust certificates, bonds, mortgages, debentures, notes, commercial paper and other securities, choses in action, evidences of indebtedness, certificates of interest or other obligations of any nature however evidenced; to exercise any and all rights, powers and privileges of individual ownership or interest in respect to any such securities or obligations, including the right to vote thereon; to acquire or to become interested in any such securities or obligations by original subscription or otherwise and irrespective of whether or not such securities or obligations are fully paid or subject to further payments.

9. To promote, finance, aid and assist financially or otherwise, any corporation or association formed under the laws of the United States or of any State, territory, colony or possession thereof, or of the District of Columbia, or of any foreign country, or any firm or individual, in the business, financing or welfare of which or of whom the Corporation has any interest of any nature, or with which or with whom it has business dealings; and in connection therewith to guarantee or become surety for the performance of or assume any undertaking or obligation, or the payment of principal of or interest on obligations and dividends on stock or other payments whatsoever, and by endorsement or otherwise to guarantee the payments of principal of and interest on bonds, debentures, notes, drafts and other securities, evidences of indebtedness and obligations; and to aid in any manner any corporation or association or any firm or individual, of which the Corporation is a creditor, or of which stock, voting trust certificates, bonds, mortgages, debentures, notes, drafts, or other securities, evidences of indebtedness, certificates of interest or obligations are held or owned by the Corporation, and generally to do any acts or things designed to protect, preserve, improve or enhance the value of any such stock, voting trust certificates, bonds, mortgages, debentures, notes, drafts or other securities, evidences of indebtedness, certificates of interest or obligations.

In furtherance and not in limitation of the general powers conferred by the laws of the State of Maryland, and of the objects and purposes hereinbefore stated, it is expressly provided that the Corporation shall also have the following powers, that is to say:

(a) To do any and all things herein set forth to the same extent and as fully as natural persons might or could do, and in any part of the world, and as principal, agent, contractor or otherwise, and either alone or in conjunction with any other individuals, firms, associations, corporations or syndicates; and to make and perform contracts of every kind and description;

(b) To borrow or raise money without limit, and upon any terms and for any purpose; to issue, sell or dispose of the Corporation's bonds, debentures, notes, certificates of indebtedness and/or other obligations, secured or unsecured and however evidenced, convertible into stock or not so convertible, upon any terms and in any lawful manner; to mortgage, convey or assign in trust, pledge, grant any charge or impose any lien upon, all or any part of the real or personal property, rights, interests or franchises of the Corporation, whether owned by it at the time or thereafter acquired;

(c) To make, execute, endorse and accept promissory notes, bills of exchange and other negotiable instruments for any of the purposes of the Corporation; and to redeem any debt or other obligation before the same shall fall due on any terms and at any advance or premium;

(d) To pay for any property, rights or interests acquired by the Corporation in money or other property, rights or interests, or by assigning, issuing or delivering in exchange therefor its own stock, bonds, debentures, notes, certificates of indebtedness and/or other obligations, secured or unsecured and however evidenced, convertible into stock or not so convertible, upon any terms and in any lawful manner; to purchase or otherwise acquire, hold, sell, convey or assign, pledge, transfer, or otherwise dispose of, and to reissue, any shares of its own capital stock (so far as may be permitted by law) and its bonds, debentures, notes, certificates of indebtedness and/or other obligations, secured or unsecured and however evidenced, convertible into stock or not so convertible, upon any terms and in any lawful manner;

(e) To do all and everything necessary or proper for the accomplishment of the objects herein enumerated or necessary or incidental to the protection or benefit of the Corporation, and in general to carry on any lawful business necessary or incidental to the attainment of the objects or purposes of the Corporation or which

may conveniently be carried on in connection with any of the business of the Corporation;

(f) To conduct its business and in connection therewith to maintain one or more offices in the State of Maryland, other States, the District of Columbia, the territories, colonies and possessions of the United States and in foreign countries.

Nothing herein shall be deemed to limit or exclude any power, right or privilege given to the Corporation by law or construed to give to the Corporation any rights, powers or privileges not permitted by the laws of the State of Maryland to corporations organized under the statutes of the State of Maryland for the purposes for which the Corporation is organized.

The foregoing clauses shall be construed as objects, purposes and powers, and it is expressly provided that the foregoing enumeration of specific powers shall not be held to limit or restrict in any manner the objects, purposes and powers of the Corporation.

FOURTH: The post-office address of the place at which the principal office of the Corporation in the State of Maryland will be located is Calvert Building, No. 101 East Fayette Street, Baltimore, Maryland, and the name of the resident agent of the Corporation is J. Bannister Hall, Jr., who is a citizen of Maryland, actually residing therein, and whose post-office address is Calvert Building, No. 101 East Fayette Street, Baltimore, Maryland.

FIFTH: The total amount of the authorized capital stock is Three Million, Eight Hundred and Eighty-five Thousand (3,885,000) shares, classified as follows:

Preference Stock	850,000 shares
without par value.	
Common Stock Class A	2,535,000 shares
without par value.	
Common Stock Class B	500,000 shares
without par value.	

The preferences, voting powers, restrictions and qualifications of the Preference Stock, the Common Stock Class A and the Common Stock Class B shall be as follows:

PREFERENCE STOCK

The holders of the Preference Stock shall be entitled, in preference to the holders of Common Stock Class A and Common Stock

Class B, to dividends, as and when declared by the Board of Directors, at the rate of Seven Dollars (\$7.) per share per annum, and no more, payable quarterly on the fifteenth days of January, April, July and October, with proper adjustment for any dividend period which is less than a full quarter; such dividends shall be cumulative from and after April 16, 1925, so that if for any dividend period dividends at the rate of Seven Dollars (\$7.) per share per annum shall not have been paid upon the Preference Stock, the deficiency shall be fully paid, but without interest, before any dividend shall be paid upon, or set apart for, the Common Stock Class A or the Common Stock Class B. In the event of the liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the holders of the Preference Stock shall be entitled to be paid One Hundred Five Dollars (\$105.) per share, together with an amount equal to all dividends thereon accrued or in arrears, whether or not earned or declared, before any amount shall be paid to the holders of Common Stock Class A or of Common Stock Class B and shall be entitled to no further payments or distribution; the Corporation however may declare and pay dividends upon any class or classes of stock without being required to accumulate any reserve or otherwise provide in advance for the payment of any sum to the holders of Preference Stock on liquidation, dissolution or winding up.

At any time and from time to time, at the option of the Board of Directors, the Preference Stock may be redeemed, in whole or in part, on any date fixed for the payment of dividends on the Preference Stock, at the redemption price of One Hundred Five Dollars (\$105) for each share of Preference Stock redeemed, together with the amount, if any, by which Seven Dollars (\$7) per annum upon each such share from the date after which dividends thereon became cumulative to the date of redemption exceeds the dividends actually paid thereon from such date to the date of redemption. If less than all the shares of Preference Stock are to be redeemed, the shares to be redeemed shall be selected by lot in such manner as the Board of Directors shall determine. Notice of the intention of the Corporation to redeem such shares of Preference Stock shall be mailed sixty (60) days before the date of redemption to each holder of record of the shares to be redeemed at his last known post-office address as shown by the Corporation's records. At any time after such notice has been mailed as aforesaid, the Corporation may deposit the aggregate redemption price

(or the portion thereof not already paid in the redemption of shares so to be redeemed) with any bank or trust company in the City of New York named in such notice, payable in the amounts aforesaid to the respective record holders of the shares so to be redeemed on endorsement and surrender of their certificates, and upon the making of such deposit said holders shall cease to be stockholders with respect to said shares and from and after the making of such deposit said holders shall have no interest in or claim against the Corporation with respect to said shares, but shall be entitled only to receive said moneys from said bank or trust company without interest. Any moneys unclaimed at the end of six years from the date of said deposit shall be repaid to the Corporation.

The holders of Preference Stock shall have no right to vote at any meeting of stockholders or election of the Corporation or otherwise to participate in any action of any nature taken by the Corporation or the stockholders thereof.

COMMON STOCK CLASS A AND COMMON STOCK CLASS B

The Common Stock Class A and Common Stock Class B shall be identical in all respects, except that the holders of Common Stock Class A shall have no voting power for any purpose whatsoever and the holders of Common Stock Class B shall, to the exclusion of the holders of Common Stock Class A and the holders of Preference Stock, have full voting power for all purposes, each holder of Common Stock Class B to have one vote for each share of such stock held by him.

The authorized amount of stock of the Corporation of any class or classes may be increased from time to time in any manner permitted by law by vote of the holders of a majority of the total number of shares of Common Stock Class B issued and outstanding. Upon the vote of the holders of a majority of the total number of shares of Common Stock Class B issued and outstanding, the Corporation may from time to time in any manner permitted by law create one or more classes of stock with such designations, preferences, voting powers, restrictions and qualifications as may be determined by such vote, which may be the same as or different from the designations, preferences, voting powers, restrictions and qualifications of the classes of stock of the Corporation then authorized or issued and outstanding. Any such vote may authorize

any shares of any class of stock then authorized but unissued to be reclassified in any manner permitted by law as shares of any other class or classes.

SIXTH: The Board of Directors of the Corporation is hereby empowered to authorize the issuance from time to time of shares of the stock of the Corporation without par value of any class, whether now or hereafter authorized, and securities convertible into shares of its stock without par value of any class, whether now or hereafter authorized, for such considerations and on such terms as said Board of Directors may deem advisable, subject to such limitations and restrictions, if any, as may be set forth in the by-laws of the Corporation.

SEVENTH: If so determined by the Board of Directors, the Corporation may from time to time receive money and/or other property upon the condition that it credit the amount or value thereof to reserve or surplus, and such money or other property may be an undivided part of a consideration for another part of which stock, bonds, debentures and/or other obligations of the Corporation are issued. Against any reserve or surplus so established there may be charged losses at any time incurred by the Corporation, also dividends or other distributions upon stock. Such reserve or surplus may be reduced from time to time by the Board of Directors for the purposes above specified, or by transfer from such reserve or surplus to capital account.

EIGHTH: No holder of any stock of the Corporation shall be entitled as of right to purchase or subscribe for any part of any unissued stock of the Corporation, or for any additional stock of any class to be issued pursuant to any increase of the authorized capital stock of the Corporation, or of bonds, certificates of indebtedness, debentures or other securities convertible into stock of the Corporation, but any such unissued stock or any such additional authorized issue of new stock, or of securities convertible into stock, may be issued and disposed of by the Board of Directors to such persons, firms, corporations, or associations, and upon such terms as the Board of Directors may, in its discretion, determine, without offering to the stockholders then of record, or any class of stockholders, any thereof, on the same terms or on any terms; and any shares or convertible securities which the Board of Directors may determine to offer for subscription to holders of stock may,

as said Board of Directors shall determine, be offered to holders of any class or classes of stock at the time existing to the exclusion of holders of any or all other classes at the time existing.

NINTH: In case the Corporation enters into contracts or transacts business with one or more of its directors, or with any firm of which one or more of its directors are members, or with any other corporation or association of which one or more of its directors are stockholders, directors or officers, such contract or transaction shall not be invalidated or in any wise affected by the fact that such director or directors have or may have interests therein which are or might be adverse to the interests of the Corporation, even though the vote of the director or directors having such adverse interest shall have been necessary to obligate the Corporation upon such contract or transaction, and even though the fact of such interest was not disclosed to other directors or stockholders acting upon or in reference to such contract or transaction. No director or directors having such adverse interest shall be liable to the Corporation or to any stockholder or creditor thereof or to any other person for any loss incurred by it under or by reason of any such contract or transaction, nor shall any such director or directors be accountable for any gains or profits realized thereon.

TENTH: The Corporation may sell, lease or exchange all of its property and franchises upon the consent of, and for such consideration and upon such terms as may be approved by, the holders of a majority of the total number of shares of Common Stock Class B issued and outstanding, expressed in writing with or without a meeting or by vote at a meeting called for that purpose in the manner provided by the by-laws of the Corporation for special meetings of stockholders.

ELEVENTH: Upon the consent of the holders of a majority of the total number of shares of Common Stock Class B issued and outstanding, expressed in writing with or without a meeting or by vote at a meeting called for that purpose in the manner provided by the by-laws of the Corporation for special meetings of stockholders, in order to effect the re-incorporation or reorganization of the Corporation without a liquidation or winding up, all the property, franchises, rights and assets of the Corporation may be sold, conveyed, assigned and transferred as an entirety to a new corporation to be organized under the laws of the United States,

the State of Maryland, or of any other State of the United States, or of any foreign state, for the purpose of so taking over all the property, franchises, rights and assets of the Corporation, with the same or a different authorized number of shares of stock, and with the same preferences, voting powers, restrictions and qualifications thereof as may then attach to the classes of stock of the Corporation then outstanding (provided that the whole or any part of such stock or of any class thereof may be stock with or without nominal or par value); the consideration for such sale and conveyance to be the assumption by such new company of all of the then outstanding liabilities of the Corporation and the issuance and delivery by the new company of shares of stock (any or all thereof either with or without nominal or par value) of such new company of the several classes into which the stock of the Corporation is then divided equal in number to the number of shares of stock of the Corporation of the several classes then outstanding. In the event of such sale each holder of stock in the Corporation agrees forthwith to surrender for cancellation his certificate or certificates for stock of the Corporation and to receive and accept in exchange therefor, as his full and final distributive share of the proceeds of such sale and conveyance and of the assets of the Corporation, a number of shares of the stock of the new company of the class corresponding to the class of the shares surrendered equal in number to the shares of stock of the Corporation so surrendered, and in such event no holder of any of the stock of the Corporation shall have any rights or interests in or against the Corporation except the right upon surrender of his certificates as aforesaid properly endorsed to receive from the Corporation certificates for such shares of such new company as herein provided. Such new company may, but need not, have all or any of the powers of the Corporation, and the charter and by-laws of such new company may, but need not, contain all or any of the provisions contained in the charter and by-laws of the Corporation.

TWELFTH: The Corporation may close its affairs and be dissolved in the manner provided by law upon the vote of the holders of a majority of the total number of shares of the Common Stock Class B issued and outstanding.

THIRTEENTH: Upon the vote of the holders of a majority of the total number of shares of Common Stock Class B issued and out-

standing, (1) any statute of the State of Maryland hereafter enacted, whereby the rights, powers or privileges of the stockholders of corporations organized under the general laws of said State are increased, diminished or in any way affected, or whereby effect is given to the action taken by any part less than all of the stockholders of any such corporation, shall, if not otherwise applicable, apply to the Corporation and shall be binding not only upon the Corporation but upon every stockholder thereof to the same extent as if such statute had been in force at the date of the receipt for record of the certificate of incorporation of the Corporation, and/or (2) amendments to the charter, authorized by the laws of the State of Maryland at the time of the making of such amendments, may be made.

FOURTEENTH: The Corporation shall have five directors, which number may be changed from time to time in such lawful manner as the by-laws of the Corporation shall provide. Robert E. Christie, Jr., Albert G. Teale, Clifford F. Stone, Cloyd Laporte and Wilkie Bushby shall act as directors of the Corporation until its first annual meeting or until their successors shall have been duly chosen and qualified. No director need be a stockholder of the Corporation.

FIFTEENTH: The Board of Directors shall have the general management and control of the business and property of the Corporation and may exercise all the powers of the Corporation except such as may be expressly limited by statute, charter or by-laws to the stockholders. Without limiting the generality of the foregoing powers and subject to and unless prohibited by the statutes of the State of Maryland, the Board of Directors, without consent or other action of the stockholders of the Corporation, may authorize the Corporation to purchase, lease or otherwise acquire, hold, mortgage, convey or assign in trust, pledge, sell, convey, lease or otherwise dispose of, such property, real and personal, without as well as within the State of Maryland, as the Board of Directors may from time to time determine, and in payment for any property or for money or any other consideration, and so far as may be lawful, to issue or cause to be issued stock of the Corporation, or bonds, debentures, notes, or other obligations thereof, secured or unsecured and convertible into stock or not so convertible.

SIXTEENTH: The Corporation is to have perpetual existence.

IN WITNESS WHEREOF, we have signed this certificate of incorporation on April 8, 1925.

GEORGE S. NEWCOMER
E. HARRY FROST
DOUGLAS H. ROSE

Witness:

CORA E. SCHOTTA

STATE OF MARYLAND, ss.:
CITY OF BALTIMORE,

THIS IS TO CERTIFY that on this 8th day of April, 1925, before me, the subscriber, a notary public of the State of Maryland, in and for Baltimore City aforesaid, personally appeared GEORGE S. NEWCOMER, E. HARRY FROST and DOUGLAS H. ROSE, and severally acknowledged the foregoing certificate of incorporation to be their act.

WITNESS my hand and notarial seal, the day and year last above written.

CORA E. SCHOTTA
Notary Public

[NOTARIAL SEAL]

APPENDIX B

SOME IMPORTANT PROVISIONS OF THE NEW OHIO CORPORATION ACT, 1927.

The new Ohio Act was drafted by a committee of the Ohio State Bar Association, and represents the thought of many eminent lawyers, professors and experts in facilitating corporate business and at the same time protecting the public. The following provisions are very similar to those of the Tenth Tentative Draft of a Uniform Business Corporation Act, prepared by Professor R. S. Stevens for the Commissioners on Uniform State Laws. (See Bickel, Ohio's New Corporation Law, 15 Georgetown Law Journal, 409; Wright, 75 Uni. Pa. Law Rev. 753.)

CHARTER LIMITATIONS AND ULTRA VIRES.

SECTION 8. Every corporation of this state, heretofore or hereafter organized, shall have the capacity possessed by natural persons to perform all acts, within or without this state.

The articles of incorporation shall constitute an agreement by the directors and officers with the corporation that they will confine the acts of the corporation to those acts which are authorized by the statement of purposes and within such limitations and restrictions as may be imposed by the articles.

No limitation on the exercise of the authority of the corporation shall be asserted in any action between the corporation and any person, except by or on behalf of the corporation against a director or an officer or a person having actual knowledge of such limitation. (See Stevens, A Proposal as to the *Ultra Vires* Doctrine, 36 Yale Law Journal, 297; Ballantine, 12 Cornell Law Quarterly, 453.)

CONSTRUCTIVE NOTICE.

SECTION 9. The filing and recording of articles and other certificates pursuant to this act is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents

thereof, but no person dealing with a corporation shall be charged with constructive notice of the contents of any such articles or paper by reason of such filing or recording. (See 10 Cornell Law Quarterly, 498.)

CONSIDERATION FOR SHARES; PAR VALUE.

SECTION 16. Shares with par value may be issued for an amount of consideration not less than the par value thereof except as herein otherwise provided. The board of directors may authorize the issuance of shares with par value at a price greater than par.

A corporation by action of its board of directors may issue and sell shares having par value or securities convertible into shares having par value, or give options to purchase shares having par value, for an amount of consideration less than the par value of such shares or of such shares as may be issued upon the conversion of such securities or exercise of such options if

(1) The corporation has been in existence more than two years; and

(2) The board of directors shall find that such shares cannot be sold at par; and

(3) The board of directors shall fix a price for such shares at less than par and cause them to be offered to existing stockholders at such price; and

(4) All of the shares so offered shall not have been purchased by existing shareholders.

Whereupon such unpurchased shares may be issued and sold at not less than the price at which such shares were offered to shareholders, less reasonable compensation for the sale or underwriting of such shares; or securities convertible into such shares may be issued and sold and the price of such shares on conversion may be fixed at an amount equal to or greater than the price at which such shares were offered to shareholders.

NON-PAR SHARES.

SECTION 17. Shares without par value may be issued:

(a) Pursuant to subscriptions taken by the incorporators, for such amount of consideration as may be specified in the articles, or if none is specified, for such amount of consideration as may be specified by the incorporators;

(b) At any time or from time to time after organization, for such amount of consideration for each share (which amount shall be equal in respect of all the shares of the same class authorized to be issued at the same time) as may be fixed by the affirmative vote of the holders of a majority of the outstanding shares of the class to be issued, and by a like vote of the holders of shares of each class junior thereto (regardless of limitations or restrictions on the voting power of any such classes) or by the board of directors when authorized by a like vote of the shareholders or by the articles, or if no shares of the class to be issued are outstanding and there are no shares junior thereto then for such amount of consideration for each share as may be fixed by the board of directors. (See *Atlantic Refining Co. v. Hodgman*, 13 Fed. (2d) 781.)

TREASURY SHARES.

SECTION 18. Shares issued and thereafter acquired by a corporation, unless required to be cancelled, may be reissued and disposed of for such consideration as the board of directors may fix.

POWER TO ISSUE CONVERTIBLE SECURITIES AND STOCK PURCHASE WARRANTS.

SECTION 20. The corporation shall have authority in connection with the issuance and sale of any securities to grant to the holders thereof rights or options to subscribe for or to purchase shares of any class or classes at such price or prices and at such time or times as may be fixed and stated in such securities or in such warrants or instruments, transferable or otherwise, evidencing such rights and options as the corporation may issue. Such authority shall be exercised by resolution of the board of directors but, unless otherwise provided in the articles, such resolution shall be effective only upon the written consent or approving vote of holders of shares entitling them to exercise a majority of the voting power on such proposal and a like consent or vote of the holders of record of a majority of the shares of the class to be issued upon the exercise of such rights or options, and a like consent or vote of each class of shares junior to the class of shares so to be issued upon the exercise of such rights or options. (See A. A. Berle, Jr., *Convertible Bonds and Stock Purchase Warrants*, 36 Yale Law Journal, 649.)

PAYMENT FOR SHARES.

SECTION 22. Every person who subscribes for par value shares or to whom such shares are issued, except as a share dividend, shall be obligated to pay the corporation therefor, in money or such other property or labor or services, not less than the full par value thereof, except as hereinabove in this act provided.

Every person who shall subscribe for shares without par value, or to whom such shares are to be issued, except as a share dividend, shall be obligated to pay the corporation therefor, in money or such other property or labor or services, such amount of consideration for each share as may have been determined as hereinbefore in this act provided.

Promissory notes, drafts or obligations, of a subscriber or purchaser, shall not be accepted in payment for shares, nor shall shares be issued for future services.

PAID-IN SURPLUS.

SECTION 23. If any part of the consideration received for shares without par value is to be treated as paid-in surplus, the incorporators, shareholders or directors, as the case may be, shall, at the time of fixing the consideration for which such shares are to be issued, fix and specify the amount of the consideration to be allotted to stated capital and paid-in surplus respectively. (See A. A. Berle, Jr., 25 Columbia Law Review, 43.)

STOCKHOLDER'S LIABILITY TO CORPORATION.

SECTION 24. When the amount of consideration for which a share was authorized to be issued shall have been received in money or property or labor or services at its fair value to the corporation, or when a share shall have been issued as a share dividend, such share shall be fully paid and non-assessable.

Every person who subscribes for shares or to whom shares are issued, except as a share dividend, shall be under no liability to the corporation in respect of such shares other than to pay in money, or other property, real or personal, tangible or intangible, or labor, or services, at such fair value, the amount of consideration for which such shares were authorized to be issued.

CERTIFICATE OF CONSIDERATION.

SECTION 26. Within sixty days after any corporation shall have issued any shares in whole or in part for considerations other than

cash, it shall file a certificate in the office of the secretary of state signed by its secretary or an assistant secretary stating:

- (a) The number and class of shares so issued;
- (b) A description of such consideration other than cash received by the corporation in payment for such shares;
- (c) The total number of shares of each class authorized by its articles and the total number of shares of each class then outstanding.

Within sixty days after any corporation shall have issued shares as a share dividend it shall file the certificate hereinabove required stating in place of (b) above:

The amount of surplus transferred to stated capital in respect to such share dividend. (See Machen, Corporations, § 799.)

STOCKHOLDER'S LIABILITY TO CREDITORS.

SECTION 28. No creditor of a corporation shall have any claim or right of action against a shareholder as such, other than to reach and apply the debt, if any, of the shareholder to the corporation arising out of his contract of subscription or purchase.

No action shall be brought by or on behalf of any creditor to reach and apply any such debt until after (a) final judgment shall have been rendered against the corporation in favor of such creditor; or (b) the corporation shall have been adjudged bankrupt; or (c) it shall have made a general assignment for the benefit of creditors; or (d) a receiver shall have been appointed with power to collect debts due to it; or (e) it shall have been dissolved; nor more than one year after the happening of any one of such events.

PRE-EMPTIVE RIGHTS.

SECTION 35. Except as otherwise provided in the articles, the holders of the shares of any class of a corporation shall, upon the sale for cash of shares of the same class, have the right, during a reasonable time to be fixed by the board of directors to purchase such shares in proportion to their respective holdings of shares of such class, at such price as may be fixed in the manner hereinbefore provided.

Unless otherwise provided in the articles, shares shall not be subject to such pre-emptive rights if

(a) Offered after organization to shareholders at a stated price and not purchased within a reasonable time fixed by the board of directors. Such shares may thereafter be sold at that price, less reasonable compensation for the sale or underwriting of such shares, unless otherwise ordered by a majority of the shareholders entitled in the absence of such offering to the right to purchase such shares; or

(b) Allotted for sale to employees under the next succeeding section; or

(c) Allotted by the board of directors for issuance for considerations other than cash; or

(d) Allotted to satisfy conversion or option rights granted by the corporation; or

(e) Released from pre-emptive rights by the holders of two-thirds of the shares of the class to be issued; or

(f) Of a class of which none are outstanding; or

(g) Such shares are treasury shares.

See 5 Fletcher, Corporations, § 3462; 25 Columbia Law Rev. 43, 56; 36 Yale Law Journal, 658; 75 Uni. Pa. Law Rev. 755.

STATED CAPITAL.

SECTION 37. Every corporation subject to this act shall have and shall carry upon its books a stated capital, which shall be an amount not less than \$500, except as otherwise provided in respect of consolidated corporations, shall be equal to

(1) the aggregate par value of outstanding shares having par value, including therein treasury shares, plus

(2) the aggregate amount of consideration received for its outstanding shares without par value, including therein treasury shares, except such portion of such consideration as shall have been expressly received and applied by the corporation as paid-in surplus; or if the shares without par value have been substituted for shares with par value, the aggregate amount of consideration received for such shares without par value shall be deemed to be the amount of the par value of the shares for which they were substituted, unless at the time of such substitution the stated capital of the corporation was reduced by appropriate proceedings, plus

(3) such amount as may be transferred from surplus to stated capital upon the declaration of a share dividend, plus

(4) in the case of a corporation having shares without par value, such amount as may be transferred from surplus to stated capital.

SURPLUS AVAILABLE FOR DIVIDENDS.

SECTION 38. No corporation shall pay dividends

(1) in cash or property, except from the surplus of the aggregate of its assets over the aggregate of its liabilities, plus stated capital, after deducting from such aggregate of its assets the amount by which such aggregate was increased by unrealized appreciation in value or revaluation of fixed assets;

(2) in shares of the corporation, except from the surplus of the aggregate of its assets over the aggregate of its liabilities, plus stated capital.

In computing the aggregate of the assets of the corporation, the directors shall determine and make proper allowance for depreciation and depletion sustained and losses of every character. Deferred assets and prepaid expenses, excepting organization expense and financing charges, shall be written off at least annually in proportion to their use as may be determined by the board of directors. Organization expense and financing charges may be written off in the discretion of the board of directors.

Cash dividends shall not be paid out of surplus due to or arising from (a) unrealized appreciation in value of or a revaluation of fixed assets, or (b) any profit on treasury shares before resale, or (c) any unrealized profits due to increase in valuation of inventories before sale, or (d) the unaccrued portion of unrealized profits on notes, bonds, or obligations for the payment of money purchased or acquired at a discount, unless such notes, bonds, or obligations are readily marketable, in which case they may be taken at their actual market value, or (e) the unaccrued or unearned portion of any unrealized profit in any form whatsoever, whether in the form of notes, bonds, obligations for the payment of money, installment sales, credits, or otherwise.

When the directors so determine, dividends may be paid in shares at the par value thereof, or, in case of shares without par value, at a value fixed by the board of directors, provided that no dividend payable in the shares of any class shall be paid to shareholders of another class unless the articles otherwise provide or

such payment is authorized by the affirmative vote of the holders of a majority of the shares of the class in which payment is to be made.

Amounts of surplus arising from an unrealized appreciation of or a revaluation of fixed assets shall be shown on the books of a corporation separate from surplus profits and capital surplus or paid-in surplus.

The excess of consideration paid in by shareholders for shares having par value over the par value thereof, or for shares having no par value over the amount allotted to stated capital with respect thereto, shall be shown on the books of the corporation as a separate item designated "paid-in surplus" or "capital surplus." In case all or any part of any cash dividend is paid out of such paid-in or capital surplus, the stockholders shall, at the time of payment, be notified of that fact.

No distribution of capital shall be designated as or made to appear to be a dividend.

A corporation which owns or is to own wasting assets intended for sale in the ordinary course of business, such as coal or ore mines or oil or gas wells, or a corporation which is to hold property having a limited life, such as a lease for a term of years, or patents, may include in its articles a provision that the depletion of such assets by sale or lapse of time need not be deducted in the computation of surplus available for dividends, and a corporation which so provides in its articles may pay dividends without deduction of such depletion, subject, however, to the rights of shareholders of different cases. (See 75 Pennsylvania Law Rev. 350.)

No dividend shall be paid to the holders of any class of shares in violation of the rights of the holders of any other class of shares.

PURCHASE OF OWN SHARES.

SECTION 41. A corporation may purchase shares of any class issued by it:

(a) When the articles authorize the redemption of such shares and do not prohibit such purchase; or

(b) To collect or compromise a debt, claim or controversy in good faith; or

(c) To the extent of the surplus available for cash dividends when authorized by the affirmative vote of the holders of two-thirds of each class of shares outstanding, regardless of limitations or restrictions on the voting power of any such class, or

by such other vote as may be prescribed in the articles, or by the board of directors when authorized by the articles, but no such purchase shall be made so as to favor any shareholder over any other; or

(d) For the purpose of resale or allotment to employees under the provisions of section 36 of this act; or

(e) From an employee who has purchased such shares from the corporation under an agreement reserving to the corporation the right to repurchase or obligating it to repurchase.

Whenever a corporation shall acquire in any way any of its own shares, they shall be carried on its books as treasury shares until disposed of by sale or reduction of stated capital.

A corporation shall not purchase its own shares except as provided in this section, nor unless after such purchase there shall remain an excess of assets over all the debts and liabilities of the corporation, plus stated capital after deducting the amount of stated capital in respect of the shares to be purchased.

SALE OF ENTIRE PROPERTY.

SECTION 65. A corporation may, by action taken at any meeting of its board of directors sell, lease, exchange or otherwise dispose of all or substantially all of its property and assets, including its good will, upon such terms and conditions and for such considerations, which may be money, stocks, bonds, or other instruments for the payment of money or other property or considerations, as its board of directors deem expedient, when and as authorized by the affirmative vote of shareholders holding shares in the corporation entitling them to exercise at least two-thirds of the voting power on such proposal, or such other proportion, not less than a majority, or vote by classes, as the articles may require, at a shareholders' meeting called for that purpose. Notice of such meeting shall be given to all of the shareholders of record of the corporation whether or not they shall be entitled to vote thereat.

Nothing in this section is intended to restrict the power of any corporation, without the authorization thereof by the shareholders, to sell, lease, exchange, or otherwise dispose of, any of its property if thereby the corporate business be not substantially limited, or if the proceeds of such property be appropriated to the conduct or development of its remaining business.

Dissenting shareholders shall be entitled to relief in the manner and under the conditions hereinafter provided. (See 6 Fletcher, Corporations, § 4011.)

DISSENTING SHAREHOLDERS; COMPENSATION.

SECTION 72. Any shareholder entitled to vote on the sale, lease or other disposition of the assets, or the consolidation of a corporation or upon an amendment to the articles which would alter the terms or provisions of outstanding shares of the class held by such shareholder who shall vote against the proposal, and any shareholder of record who was absent from the meeting or who was not entitled to vote, may object in writing within twenty (20) days after the vote authorizing any such action, and at that time demand in writing the payment of the fair cash value of his shares, and the corporation shall, within thirty days after the receipt of such demand, unless it is withdrawn with the consent of the corporation, pay to such shareholder upon surrender of his certificate or shares the fair cash value of his shares as of the day before such vote was taken.

The shares to be paid for shall, in the case of an amendment for the purpose aforesaid, be only the shares of the class the terms and provisions of which are to be altered by such amendment.

In case of disagreement as to such fair cash value, either the corporation or the consolidated corporation, or the dissatisfied shareholder may, within six months after such demand is made, but not thereafter, petition the court of common pleas of the county in which such corporation or the consolidated corporation has its principal office to appoint, and thereupon such court shall appoint three appraisers to determine the fair cash value of the shares as aforesaid. (See Weiner, Payment of Dissenting Stockholders, 27 Columbia Law Rev. 547, 563.)

BONDHOLDERS MAY BE GIVEN VOTING POWER, ETC.

SECTION 77. A corporation, if appropriate provision is made therefor in its articles, may, upon the affirmative vote of the holders of shares entitling them to exercise two-thirds of the voting power, or such other proportion, not less than a majority, or vote by classes, as the articles may require, at a meeting called for the purpose, confer upon the holders of any bonds, debentures, or obligations issued or to be issued by such corporation, whether secured

by mortgage or otherwise, the power to vote on election of directors and in respect of the corporate affairs and management of the corporation and, in such case, shall fix the extent to which and the conditions and the manner in which such power to vote shall be exercised; provided, however, that when such voting power has been conferred it shall not be diminished as to any bonds, debentures or obligations while they are outstanding, and, likewise, subject to such restrictions or qualifications as may be stated in the articles, a corporation may confer upon the holders of bonds, debentures or obligations the right of inspection of books of account and minutes of meetings, and any other rights which the shareholders of said corporation have or may have.

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